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Report on the Valuation and Reporting of Cultural, Heritage and Infrastructure Assets
Mr P Loney, MP (Chairman)
Ms A Barker, MP
Mr R Clark, MP
Ms S Davies, MP
Hon. D Davis, MLC
Hon. R Hallam, MLC (Deputy Chairman)
Mr T Holding, MP
Mrs J Maddigan, MP
Hon. G Rich-Phillips, MLC
Hon. T Theophanous, MLC

This Inquiry was undertaken by a Sub-Committee comprising the following Members:

Hon. R Hallam, MLC (Sub-Committee Chairman)
Mr T Holding, MP
Mr P Loney, MP
Mrs J Maddigan, MP
Hon. G Rich-Phillips, MLC

1 Appointed as a Member of the Committee on 25 September 2001
2 Appointed as a Member of the Committee on 6 September 2000
3 Appointed as Deputy Chairman of the Committee on 4 October 2000
Staff:

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Specialist Advisers for the Inquiry: Mr John Chan-Sew, a public sector reform consultant, provided specialist research support and advice during the preparation of this report; and

Mr Ian Langfield-Smith provided research assistance during the hearings.

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DUTIES OF THE COMMITTEE

The Public Accounts and Estimates Committee is a joint parliamentary Committee constituted under the Parliamentary Committees Act 1968, as amended.

The Committee comprises ten Members of Parliament drawn from both Houses of Parliament and all political parties and includes an Independent Member.

The Committee carries out investigations and reports to Parliament on matters associated with State financial management. Its functions under the Act are to inquire into, consider and report to the Parliament on:

(a) any proposal, matter or thing connected with public administration or public sector finances;

(b) the annual estimates or receipts and payments and other budget papers and supplementary estimates of receipts and payments presented to the Assembly and the Council.

In consultation with the Auditor-General, the Committee provides advice on the objectives of performance audits and identifies any particular issues that need to be addressed during these audits.
### Glossary

| **AAS 27** | Australian Accounting Standard AAS 27 ‘Financial Reporting by Local Governments’ sets out the reporting requirements for the preparation and presentation of financial statements by councils in the Local Government sector. |
| **AAS 29** | Australian Accounting Standard AAS 29 ‘Financial Reporting by Government Departments’ sets out the reporting requirements for the preparation and presentation of financial statements by Government Departments. |
| **AAS 31** | Australian Accounting Standard AAS 31 ‘Financial Reporting by Governments’ sets out the reporting requirements for financial reporting by Commonwealth, State and Territory Governments. |

**Accrual accounting**

Recognition of revenue, expenses, assets, liabilities and equity when the economic transaction occurs, irrespective of the timing of the related cash flow. For example, revenue from sale of goods is recorded as of the invoice date rather than the date on which payment is received.

**Accumulated depreciation**

The aggregate, at a given point of time, of the depreciation charges made in respect of a particular depreciable asset or class of depreciable assets since acquisition.

**Agencies**

Departments or other public bodies as defined in the *Financial Management Act* 1994.

**Assets**

Service potential or future economic benefits controlled by an entity (eg. a Department) as a
result of past transactions or other past events. Assets may be physical (e.g. plant, equipment or buildings) or non-physical (e.g. financial investments). Assets may also be current (having an economic benefit which is expected to be realised in one year or less) or non-current (having an economic benefit that is expected to be realised over a period of more than one year).

<table>
<thead>
<tr>
<th>Term</th>
<th>Definition</th>
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<tbody>
<tr>
<td>Capitalisation</td>
<td>Recognising the value of an item as an asset rather than as an expense.</td>
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<tr>
<td>Community service obligation</td>
<td>The non-commercial programs and activities of Government business enterprises designed to meet community and social objectives determined by Government.</td>
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<tr>
<td>Control of an asset</td>
<td>The capacity of an entity to benefit from the asset in the pursuit of the entity’s objectives and to deny or regulate the access of others to that benefit.</td>
</tr>
<tr>
<td>Cost of acquisition</td>
<td>The ‘purchase consideration’ plus any cost incidental to the acquisition.</td>
</tr>
<tr>
<td>Current cost</td>
<td>The cost of an asset measured by reference to the lowest cost at which the gross ‘service potential’ of that asset could currently be obtained in the normal course of business. (Statement of Accounting Practice SAP 1, ‘Current Cost Accounting’).</td>
</tr>
<tr>
<td>Current market value</td>
<td>The price that a willing but not anxious seller would accept from a willing but not anxious buyer for an asset in an arm’s length transaction at current prices. This does not include transaction costs.</td>
</tr>
<tr>
<td>Current market buying price</td>
<td>The amount for which an asset with similar service potential could be bought by a knowledgeable, willing buyer from a</td>
</tr>
<tr>
<td>Term</td>
<td>Definition</td>
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<tr>
<td>knowledgeable, willing seller in an arm’s</td>
<td>knowledgeable, willing seller in an arm’s length transaction at current prices, plus the buyer’s transaction costs. This equates to current market value plus the buyer’s transactions costs.</td>
</tr>
<tr>
<td>length transaction at current prices, plus</td>
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<tr>
<td>the buyer’s transaction costs. This equates</td>
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<td>to current market value plus the buyer’s</td>
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<tr>
<td>transactions costs.</td>
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</tr>
<tr>
<td>Current replacement cost</td>
<td>This relates to a current cost estimated as the cost per unit of service potential of the most appropriate modern equivalent replacement facility. It applies where the asset being valued cannot be replaced by an asset with the same service potential and would be replaced at balance date by a different asset (in terms of scale and/or technology) having a similar service potential which would be used as a reference for determining the replacement cost per unit of service potential of the existing asset.</td>
</tr>
<tr>
<td>Current reproduction (replication) cost</td>
<td>This relates to a current cost by reference to the cost per unit of service potential of reproducing or replicating the unit. It applies where the asset being valued would be replaced at balance date by a similar asset in terms of both scale and technology.</td>
</tr>
<tr>
<td>Depreciation</td>
<td>The allocation of the cost or revalued amount of an asset over the years of its useful life.</td>
</tr>
<tr>
<td>Depreciable amount</td>
<td>The historical cost of a depreciable asset, or other revalued amount substituted for historical cost, in the financial report, less in either case, the net amount expected to be recovered on disposal of the asset at the end of its useful life.</td>
</tr>
<tr>
<td>Depreciable asset</td>
<td>A non-current asset having a limited useful life.</td>
</tr>
<tr>
<td>Depreciation expense</td>
<td>An expense recognised systematically for the purpose of allocating the depreciable amount of a depreciable asset over its useful life.</td>
</tr>
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Deprival value  
Deprival value is described as the cost to an entity if it were deprived of an asset and was required to continue to provide goods and services or deliver programs using that asset. Under this approach, assets are valued at an amount that represents the entire loss that might be expected to be incurred if the entity were deprived of the service potential or future economic benefits of those assets at the reporting date. Thus the value to the entity, in most cases, will be measured by the replacement cost of the services or benefits currently embodied in the asset, given that deprival value will normally represent the cost avoided as a result of controlling the asset and that the replacement cost represents the amount of cash necessary to obtain an equivalent or identical asset.

Fair value  
The amount for which an asset could be exchanged between a knowledgeable, willing buyer and a knowledgeable, willing seller in an arm’s length transaction.

Financial reporting  
Refers to the process of preparing financial statements based on accounting standards and other authoritative pronouncements to meet the information needs common to users and discharge accountability obligations.

Financial statements  

Government business enterprise  
A publicly owned entity providing goods or services on commercial terms with the objective of recovering its costs of production and, in most cases, of providing some financial return to its owner.

Heritage and
<table>
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<tr>
<td><strong>Cultural assets</strong></td>
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<td><strong>Historical cost</strong></td>
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<td><strong>Infrastructure assets</strong></td>
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<tr>
<td><strong>Materiality</strong></td>
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<tr>
<td><strong>Net present value (discounted cash flow)</strong></td>
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<td>Non-current assets</td>
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<tr>
<td>Public Sector</td>
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<tr>
<td>Recognition</td>
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<tr>
<td>Recognition of assets</td>
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(a) it is probable that the future economic benefits embodied in the asset will eventuate; and

(b) the asset possesses a cost or other value that can be measured reliably.

<table>
<thead>
<tr>
<th>Recoverable amount</th>
<th>In relation to an asset, the net amount that is expected to be recovered through the cash inflows and outflows arising from its continued use and subsequent disposal.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Relevance</td>
<td>That quality of financial information which exists when that information influences decisions by users about the allocation of scarce resources by:</td>
</tr>
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</table>

(a) helping them form predictions about the outcomes of past, present and future events; and/or

(b) confirming or correcting their past evaluations;

and which enables users to assess the
rendering of accountability by preparers.

Reliability
That quality of financial information which exists when that information can be depended upon to represent faithfully, and without bias or undue error, the transactions or events that it either purports to represent or could reasonably be expected to represent.

Renewal accounting
Renewal accounting is an alternative to conventional accounting for depreciation of infrastructure assets. The premise underlying renewal accounting is that infrastructure assets have infinite useful lives and that operating capacity can be maintained in perpetuity. As a substitute for depreciation expense, the annual renewal expenditure to maintain the operating capability of the network is charged as an expense in the Statement of Financial Performance.

Restricted-use assets
Assets which are subject to legal or natural restrictions on their use. The basis for the restriction may be:
(a) inherent in the asset itself;
(b) imposed by the government or law;
(c) imposed by a donor or grantor; or
(d) imposed by the controlling entity.

Revaluation
The act of recognising a reassessment of values of non-current assets at a particular date.

Statement of cash flows
A statement that provides information on the cash inflows and outflows as they relate to operating, investing and financing activities of an entity. The net cash flow is added to the opening balance to report the cash on hand at the end of the reporting period.

Statement of assets and liabilities of an entity. The
<table>
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<th>Term</th>
<th>Definition</th>
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<tr>
<td>financial position</td>
<td>statement also reflects the net worth of an entity for the reporting period. (Also known as a balance sheet).</td>
</tr>
<tr>
<td>Statement of financial performance</td>
<td>A statement providing information for the reporting period on the revenues and expenses and the surplus or deficit of an entity consistent with Australian Accounting Standards AAS 1 (also known as an operating statement).</td>
</tr>
<tr>
<td>State-owned enterprises</td>
<td>Widely used as an alternative term for Government business enterprises. Strictly speaking, however, a Government business enterprise in Victoria is a State owned enterprise only if it has been declared by the Treasurer as such under the provision of the State Owned Enterprises Act 1992.</td>
</tr>
<tr>
<td>Useful life</td>
<td>In relation to a depreciable asset, means the estimated total period from the date of acquisition, over which the service potential of an asset is expected to be used up in the business of the entity.</td>
</tr>
<tr>
<td>Written-down replacement cost</td>
<td>The current cost of replacing the service potential of the asset minus the accumulated amount of depreciation for the asset.</td>
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CHAIRMAN’S INTRODUCTION

Over the past ten years, successive Governments in Victoria have introduced a wide range of financial management and accountability reforms. The centre-piece of the reform agenda was the change from cash to accrual accounting.

The Committee is strongly supportive of the aims of the accrual accounting reform but is also aware of some practical problems associated with this radical change, particularly in the area of asset valuation.

The Committee’s Inquiry was initiated because of the concerns of some agencies about the appropriateness of applying aspects of the accounting standards to cultural, heritage and infrastructure assets. Also, there was a view held by a number of cultural institutions that the special features of cultural and heritage assets render it not only difficult, but indeed pointless and inappropriate, to ascribe dollar values to these assets.

The Inquiry is important in providing a forum to publicly canvass the divergent points of views and also to review the valuation experience of agencies.

The Committee noted significant problems with the existing accountability framework for asset management. Hence, one of the key recommendations of the report is the introduction of a comprehensive stewardship reporting regime requiring agencies to fully explain their performance in managing the assets under control. The Committee views the financial value of assets as being only one part of the overall accountability disclosure.

The Committee also noted that the approach of Victoria, and other Australian jurisdictions, to the valuation of cultural and heritage collections is out of step with the rest of the world. Other major countries, for example the United Kingdom, do not have a mandatory requirement for these assets to be valued. The report urges the accounting profession to exhibit leadership in bringing the Australian approach into line with international standards as part of the convergence initiative.
In this report, the Committee has also put forward a comprehensive action plan aimed at taking the valuation process forward and setting a new direction for agencies in the Victorian public sector. The plan provides a strategy to resolve existing accounting issues; to streamline the valuation processes of agencies; to further improve asset management across the public sector; and to maximise the use of asset valuation information.

The Committee believes that the adoption of the new strategy will lay the foundations for a more consistent, reliable and cost-effective asset valuation and management approach for the future. To successfully implement this strategy, ongoing commitment from senior management within agencies will be crucial.

In compiling this report, the Committee has drawn heavily on the material and views presented by a number of people and organisations through submissions and public hearings. The Committee is grateful for this participation.

I thank the other Members of the Sub-Committee for their commitment and contribution to a difficult and complex Inquiry. I particularly want to mention the very significant contribution made by the Chairman of the Sub-Committee, The Honourable Roger Hallam.

Our greatest gratitude must go to Mr John Chan-Sew, the Committee’s specialist advisor, whose insights and knowledge of this matter were of great assistance to the Committee, and to Mr Ian Langfield-Smith and Ms Michele Cornwell who provided research assistance during the course of the Inquiry. Thanks also go to the staff of the Committee’s secretariat particularly Frances Essaber and Annette Lambeff.

I commend the report for consideration and I look forward to the Government’s response to the Committee’s recommendations.

Peter Loney, MP
Chairman
The Public Accounts and Estimates Committee has not only enthusiastically supported the financial reform agenda as pursued by successive Victorian governments over recent years, but can claim some credit for both the pace and direction of that agenda.

The fact that the objectives of financial accountability and disclosure have continued unabated over those years, despite changes in committee membership and leadership, and even government, is a compliment to Members and staff alike.

This history and commitment made the Committee an ideal vehicle to examine the outcome of the shift from (crude) cash accounting to a full accrual system. The most contentious feature of this change had been the need to value every public asset for inclusion on the State’s balance sheet. Not only had this represented a massive undertaking, and prompted some resistance on the basis of workload, the decision to specifically include cultural, heritage and infrastructure assets had caused more hackles to rise on the question as to whether it was even possible to ascribe a commercial valuation to such assets, leave alone the point in doing so.

It was against this background that the Committee decided to review the situation, and to consider the ramifications of including cultural, heritage and infrastructure assets in particular.

The Committee knew this brief would be difficult, and was certainly not disappointed on that score. Not only did it expect to be confronted with a range of complex technical issues, but an overlay of professional sensitivities and the re-opening of some ‘bottom-line-mentality’ debates that had accompanied the original policy introduction.

Added to this was the fact that the rest of the Western World had effectively left the valuation of many of these assets in the ‘too-hard’ basket … with receding prospect that Australia’s initiative was to be followed. This posed the added basic question of how
Victoria’s position could be reconciled with the push for international convergence of financial standards on the one hand, and the ‘trauma’ of reversing the valuation ruling given its unwelcome impact on the bottom line of the Budget and the State Public Sector Annual Financial Report on the other hand.

And the complications didn’t stop there! Two of our best known cultural institutions had published collection valuations of quite unbelievable disparity, and an unrealistic ruling in respect of assumed road life had created depreciation charges of such proportion across Local Government that the entire reform agenda was facing challenge and ridicule.

So, the Committee’s public hearings were undertaken with some trepidation, but this quickly changed when the Members met and took evidence from so many dedicated and competent witnesses … even though there was a divergence of views.

The Committee found it very difficult to dismiss the argument that for some collection assets in particular, it was not only difficult but pointless to ascribe commercial values. Against that, the Committee quickly concluded that it was going to be difficult to fashion a definitional boundary to localise the valuation difficulties, and that any attempt to do so would simply re-locate the debate rather than resolve it.

In the end, it was resolved that the only practical route was to retain the mandatory valuation policy, and to address the practical problems of determining values through co-operation across the professions and a realistic position in respect of such matters as sampling and ‘ownership’. (For example, in respect of sampling the Committee acknowledges that a compromise must be struck between the cost of the valuation process and the integrity of the product, and the Committee’s view of ownership would certainly preclude the valuation of land under roads).

In all of this, the Committee was constantly reminded that the valuation of assets ruling had been introduced as a means of improving the management of our most valuable assets … some of which are literally irrereplaceable.
The Committee’s conclusion was that quite apart from any question of the extent of management benefits derived from the valuation process, these needed to be supported by a supplementary stewardship reporting regime. Indeed, the Committee considered this to be the most important feature of the report, and formally resolved that the supplementary regime should include all public assets as distinct from those merely difficult to value.

I consider the range of recommendations framed by the Committee to be a valuable sign-post in the future direction of public sector accounting for asset management, and I extend my thanks to the Members of the Sub-Committee for their investment in heart and soul.

I commend all the witnesses who were prepared to appear before the Committee in public hearings and argue their case. It would not have been possible to consider the many difficult issues, much less address them, without such input.

Finally I pay tribute to the Committee’s hard-working and dedicated staff who provided research and administrative support during this Inquiry, Ms Michele Cornwell and Ms Frances Essaber, and to our specialist adviser, Mr John Chan-Sew, for his professionalism and patience.

Roger M Hallam, MLC
Sub-Committee Chairman
EXECUTIVE SUMMARY

Chapter 1: Introduction

Successive Governments in Victoria, over the last ten years, have introduced a wide range of economic, financial management and accountability reforms. The centre-piece of this reform agenda has been the move from cash accounting to a full accrual system which requires accounting for income and expenses as they are earned or incurred as distinct from merely reporting the cash flows resulting from those transactions.

The adoption of the accrual system required the inclusion of all publicly held assets in the State’s balance sheet. This represented an enormous undertaking, but without accurate and reliable information on the value of the assets held by the State, agencies could not be expected to make informed decisions on resource management, and the funding and pricing of outputs. In turn, the accounting treatment applied in the valuation and depreciation of those assets would have major financial, budgetary and asset management implications. The Committee’s view is that, unless a robust and consistent approach is adopted across the public sector, the value of the Government’s reforms could well be eroded.

All agencies across the Victorian public sector have now valued their asset portfolios as required by the accounting standards. However, the Committee was aware that a number of agencies still held some concerns about the appropriateness of applying these standards across the public sector, particularly in respect of cultural, heritage and infrastructure assets. In the case of cultural and heritage assets, for example, the argument commonly put forward was that the special features of these assets rendered it not only difficult, but indeed pointless and inappropriate, to ascribe dollar values to them.

The Committee has for some years been very supportive of the management reform program, and the shift from cash to accrual accounting in particular. However, this support has not been oblivious to the practical problems associated with the quite
radical changes, or the extent to which Victoria was leading the way and therefore there was no experience in other jurisdictions from which to learn.

It was against this background that the Committee decided to undertake an Inquiry as a forum to publicly canvass the divergent points of view and also to review the valuation experience of agencies as a post-implementation assessment.

The aim of the Inquiry was to:

- formulate a proposed action plan to resolve the existing issues;
- streamline the valuation processes of agencies;
- improve accountability for the management of public sector assets; and
- maximise the use of asset valuation information for the benefit of agencies and the Government as a whole.

Chapter 2 : Reporting of Cultural, Heritage and Infrastructure Assets

The issue of recognising ‘assets’ in the financial statements dominated the evidence presented at the public hearings and in the submissions received.

Against this background, a threshold issue examined by the Committee was whether the characteristics shown by the cultural and heritage assets of the Victorian public sector meet the definition of ‘assets’ and the recognition criteria contained in the accounting standards.

The Australian Accounting Standards Board, the Department of Treasury and Finance, the Auditor-General’s Office and most agencies emphasised that all public sector assets should be recognised in the financial statements, without exception. On the other hand, some cultural institutions and academic commentators argued that cultural and heritage assets should be exempt from recognition in the financial statements because those assets have special characteristics. There was, however, some support for the suggestion that a supplementary stewardship reporting regime
should be established to improve accountability for this particular category of assets.

The Committee notes that the accounting standards clearly presume cultural and heritage assets, despite their special characteristics, normally meet the requirement for recognition. It further notes that the asset recognition criteria applied to public sector reporting in Australia are consistent with those adopted in other major overseas countries.

Indeed, the experience of agencies indicates it to be a rarity that an agency cannot obtain a reliable value for a cultural or heritage or infrastructure asset based on the valuation model commonly adopted in the public sector across Australia. However, practical problems and inconsistent approaches are acknowledged to still exist in the valuation of certain types of cultural, heritage and infrastructure assets.

In the case of heritage and cultural collections, the Committee notes that Australia and New Zealand are the only two countries in the world that have imposed a mandatory requirement for their valuation. At present, valuation is not compulsory in the United States, Canada and the United Kingdom nor under the International Public Sector Accounting Standards. Australia is clearly out of step with the rest of the world.

Currently, there is a move within Australia to adopt International Accounting Standards for both the private and public sectors as part of the international convergence initiative of the standard-setting body. In the light of these developments, the Committee believes that the Australian Accounting Standards Board should undertake a re-examination of the requirement that public sector agencies ascribe a value to collection assets for financial reporting purposes.

However, quite apart from the position ultimately adopted by the Australian Accounting Standards Board on this particular issue, the Committee strongly recommends that in order to further enhance accountability for the management of cultural and heritage (including collection) assets, a supplementary stewardship reporting regime be adopted by all cultural institutions to augment the existing financial reporting framework.
Further, the Committee is of the view that a separate stewardship reporting regime should be introduced requiring all agencies to report on their performance in managing the infrastructure and other physical assets (excluding cultural and heritage assets) under their control.

Stewardship reporting is a prominent feature of the public sector reporting framework in the United States and has been recognised to a lesser extent in Canada and in the United Kingdom. To ensure the integrity and reliability of the stewardship information (including key performance indicators) published by Victorian agencies, the Committee believes it is essential that the additional disclosures be subject to audit by the Auditor-General in line with the practices in some other Australian jurisdictions and overseas countries.

Chapter 3: Asset Valuation Approach

During the Inquiry, the Committee sought evidence on whether the asset valuation methods adopted by agencies in Victoria are appropriate for their operational and financial requirements and for external reporting purposes. Asset valuation is a major component of the Government’s accrual accounting, output budgeting and corporatisation reform initiatives. It follows that to realise the benefits of the reforms, the valuation approach must be appropriate in terms of the objectives set by the Government.

Public sector agencies in Victoria have valued their cultural, heritage and infrastructure assets using the ‘deprival value’ method. The Department of Treasury and Finance has issued a policy document on asset valuation, but not practical guidelines to support it. As a result, many agencies have developed their own internal policies and procedures, often with the assistance of external valuers and consultants.

Agencies generally support the adoption of the ‘deprival value’ method for infrastructure assets. However, a number of concerns were brought to the attention of the Committee regarding aspects of the implementation process. During the course of this Inquiry, the Committee was unable to ascertain the extent of these problems.
In the case of cultural and heritage assets, a significant majority of the cultural institutions have accepted the ‘deprival value’ method. However, a number of institutions still challenge the appropriateness of ascribing a financial value to an asset they deem to be ‘priceless’, and maintain that cultural and heritage assets should be exempted from the valuation rules on the basis of their special characteristics. A range of practical issues have been identified by these cultural institutions as requiring resolution.

It is acknowledged by most agencies that the benefits of asset valuation have exceeded the costs. The Committee was given examples in which information on the value of assets and the costs of maintenance and depreciation had been employed by agencies to make decisions on a wide range of matters relating to, for example performance assessment, resource allocation, pricing of outputs and asset management.

The Committee has concluded that the valuation methods adopted in Victoria for cultural, heritage and infrastructure assets are capable of meeting the financial and operational requirements of agencies, as well as assisting in the discharge of their external reporting obligations.

While most agencies have now settled on a valuation process after a number of years of experience, the Committee believes that considerable benefits could flow from the Department of Treasury and Finance assuming a more active role in providing practical guidance, training and support to agencies. This would achieve a more consistent, reliable and cost-effective approach to asset valuation across the Victorian public sector.

Given the recent introduction of a new accounting standard AASB 1041 ‘Revaluation of Non-Current Assets’, the Committee believes that clarification is now urgently needed from the Australian Accounting Standards Board as to the full implications of the adoption of the ‘fair value’ basis of valuation as required by the standard method. Pending advice from the Board, the Department of Treasury and Finance has instructed agencies to continue to use ‘deprival value’ as a surrogate for ‘fair value’.

The Committee notes that some agencies have embraced the valuation task and its underlying rationale more enthusiastically
than others, and believes that the whole area of asset management could be improved across the public sector by strengthening the link between the planning, accounting and asset management systems of agencies. This linkage has assumed even greater importance given the Government’s determination to have agencies adopt best practice.

It is the Committee’s strongly held view that agencies should be directly accountable for the management of the assets under their control. Therefore, it should be their responsibility to ensure that adequate resources and priority are given to this particular area and that performance in asset management is assessed within the internal accountability process.

Chapter 4 : Depreciation of Cultural, Heritage and Infrastructure Assets

The depreciation methodology adopted by agencies has a direct impact on the depreciation expense recorded in the financial statements. This particular expense can have a significant influence on the reported operating results of an agency, as well as implications for the pricing of products and services and asset management.

In general, agencies have found the depreciation methods prescribed in the accounting standards to be suitable for performance assessment, asset management and pricing/funding decisions within the Victorian public sector.

The Committee notes that a clear set of accounting rules on depreciation and maintenance has been developed and circulated, and that these are consistent with those adopted by other major countries. It also notes that the Urgent Issues Group of the Australian Accounting Standards Board recently provided guidance on specific issues raised by the public sector including the application of condition-based depreciation and renewals accounting.

Against this, some agencies still express concerns about the practical application of aspects of the depreciation methods. Examples cited to the Committee included difficulties in establishing accurate useful lives for long-lived assets; the
potential for manipulation of depreciation and maintenance charges; and inconsistency of application to similar assets.

The Committee recommends that the Department of Treasury and Finance provide further detailed practical guidance to assist agencies. It further recommends that formal arrangements be set up to facilitate the exchange of knowledge, experience and information among agencies, as well as the benchmarking of depreciation practices within specific sectors.

The Committee notes that many of the issues examined in accounting for depreciation (for example, condition of assets) are also relevant to maintenance planning and funding, asset acquisitions and disposals. Agencies, therefore, need to ensure that their accounting approach to depreciation is fully integrated with their asset management processes.

Chapter 5 : Cost and Reliability of Asset Valuation

Given the acknowledged benefits of the valuation information to both internal agency managers and external stakeholders, the Committee was interested to learn about the costs incurred in the valuation process and the reliability of the values produced by that process.

For the Victorian public sector, external valuation experts undertook or supervised the asset valuations in many cases. In some instances, the Victorian Valuer-General’s Office was involved in managing the valuation process. For collection assets held by cultural institutions, the Committee learned that sampling methods were widely used, to minimise the cost of valuation while maintaining the integrity of the process.

The Department of Treasury and Finance was unable to advise the Committee of the total cost of the initial valuations for the whole Victorian public sector, and noted that many agencies had upgraded their asset management systems as part of the process, which would make any costings very difficult to extract.

In any event, there was general agreement that the costs of future revaluations should be substantially lower, given that the asset records, valuation methods and management systems are now in
place. Moreover, the lessons learned from the initial projects should be instructive in the development of future revaluation processes.

The Committee acknowledges that obtaining reliable values for certain categories of cultural and heritage assets remains difficult. For example, the sampling processes adopted by the cultural institutions have been found to be problematic in a number of respects because of the arbitrariness involved, the diversity of the items in the collections and also the inherent limitations of sampling.

Agencies cited improvements in conservation and preservation practices, record-keeping, the allocation of funding and resources, and risk management as direct benefits derived from the valuation of cultural and heritage assets.

Some cultural institutions argued that the claimed management benefits of valuation could be obtained without assigning a dollar value to the collection assets and that effective decisions regarding the priority and allocation of funding could be made without knowing the dollar value of the items involved.

These matters and views were carefully considered by the Committee in framing its recommendations. The Committee was not convinced that the benefits derived from the valuation of some categories of cultural and heritage assets warranted the costs involved and certainly concluded that the claimed benefits would not apply equally to all cultural institutions. The fact that heritage collections are not subject to mandatory valuation in most countries was noted, as indeed were the financial reporting ramifications of any reversal of the ruling currently applicable across Australia.

On balance, and at the very least pending any change in accounting standards, the Committee would advocate that agencies and valuers work together to develop a more rigorous and consistent valuation methodology. It is clear that existing valuation processes could be made more cost-effective by better sharing of knowledge, experience and information across the public sector and also by the adoption of various cost minimisation techniques during revaluations.
The Committee also believes that efforts should be made to enable cultural institutions to learn from those that have derived significant management benefits from asset valuation with the view to maximising the return from the expenditures incurred.

**Chapter 6 : Reporting Practices in Major Overseas Countries**

Over the past ten years, most of the major countries around the world have implemented significant financial management and accountability reforms for the public sector. A key element of the reforms has been the adoption of commercial accounting principles for preparing Government agencies’ financial reports. While the progress of implementation varies from country to country, Australia is certainly at the forefront, particularly in financial reporting.

While many countries have established accounting standards for the public sector similar to those in Australia, others have simply applied the private sector accounting standards to the public sector, with minor adaptations.

The asset valuation approaches around the world are a mix of historical cost and current value. The North American countries use the historical cost method, while Australia, New Zealand and the United Kingdom, for example, have adopted the current value (or ‘fair value’) method.

Another important observation is that the United States, Canada and the United Kingdom have decided not to adopt a comprehensive approach to asset valuation at the present time, unlike Australia and New Zealand where all assets within the public sector are required to be valued with no exceptions.

For example, in the United States, certain assets of their Federal agencies such as heritage assets that are not directly related to the provision of Government services as well as ‘stewardship land’ (for example, park land and forest land) and collection assets are not required to be valued. In the United Kingdom, Government agencies also do not have to value particular categories of assets including non-operational land and buildings and collection assets.
A similar non-comprehensive approach to asset valuation has also been adopted in the new international accounting standard IPSAS 17 on ‘Property, Plant and Equipment’ which was issued in December 2001 by the Public Sector Committee of the International Federation of Accountants (IFAC). Under the new standard, the recognition of heritage assets is not mandatory at this stage. The Committee was informed that the Public Sector Committee intends to further consider, as part of its work program, the measurement of heritage assets particularly the development of reliable valuation methods that are acceptable to IFAC member countries.

Based on the review of overseas reporting practices, the Committee can see a compelling case to be put to the Australian Accounting Standards Board that the current requirement to value cultural and heritage assets and ‘stewardship land’ (e.g. national parks and reserves) be reviewed. The Australian requirement is clearly out of step with the rest of the world and is at odds with the Commonwealth Government’s commitment to converge Australian accounting standards with international standards.

The Committee has identified at least two major overseas countries, (the United States and the United Kingdom) where an alternative approach to the conventional methods of depreciation is allowed for infrastructure assets in certain specified circumstances. The main reason the departure from the conventional methods has been accommodated in those countries is the view that other methods of measuring the consumption of service potential may be more appropriate given the special characteristics of infrastructure assets. The Committee, therefore, is of the view that the Australian Accounting Standards Board should review its existing accounting standards on depreciation, taking into account the practices in other major countries.

Chapter 7: Asset Valuation – The Way Forward

Experience has shown that many of the issues encountered in asset valuation are common to many agencies but, at present, there are no formal mechanisms within the Victorian public sector to facilitate the resolution of general issues and the exchange of knowledge, experience and information between agencies.
To assist agencies in taking the asset valuation process forward, the Committee has recommended the adoption of a new strategy with a number of key elements. The elements cover both the accounting/reporting rules as well as the implementation process. The Committee believes that the adoption of the strategy will lay the foundations for a more consistent, reliable and cost-effective asset valuation approach for the future.

The main focus of the proposed strategy is centred on all agencies working together in undertaking future valuations and the Department of Treasury and Finance assuming an active policy leadership, education and co-ordination role. Both the Auditor-General’s Office and the Valuer-General’s Office should also play a significant part in the resolution of issues identified by agencies.

The development of an asset valuation manual, and the establishment of a reference group are two of the other key elements under the strategy recommended by the Committee. The manual is intended to be a ‘living’ document and to provide a roadmap to help agencies in delivering the outcomes desired by the Government. The reference group (with wide representation from agencies) is suggested as a means of resolving asset valuation and other related issues.

To successfully implement this proposed new approach to asset valuation and management, it is the Committee’s view that the Department of Treasury and Finance would also need to gain an ongoing commitment from the senior management of agencies. This in turn may require the application of a Communication and Education Strategy to raise the level of awareness and understanding of the process involved and the objectives that it is designed to achieve.
CONCLUSIONS AND RECOMMENDATIONS

On completion of the Inquiry, the Committee came to the following major conclusions in relation to the matters examined under the terms of reference:

- the reporting of an accounting (or financial) value for cultural, heritage and infrastructure assets is grossly inadequate in holding public sector agencies accountable for their stewardship responsibilities relating to the management of those assets;
- at present, there is no legislative or policy requirement for agencies in Victoria to report on performance in managing the assets under their control;
- the Committee believes that there is a compelling case for the adoption of a comprehensive stewardship reporting regime for cultural, heritage and infrastructure assets. This reporting regime should be the primary focus of the accountability framework for asset management with the financial value of assets forming only part of the overall disclosure in the annual financial statements;
- because the stewardship information is of critical importance to the stakeholders of agencies, it should be subject to an external independent review by the Auditor-General as to its relevance, reliability and integrity;
- the current mandatory requirement for agencies in Victoria (and other Australian jurisdictions) to value cultural and heritage collection assets is out of step with the approaches adopted by other major countries around the world. Countries such as the United States, Canada and the United Kingdom and also the International Public Sector Accounting Standards do not require public sector agencies to value their collection assets. Their position is premised on the view that the benefits of valuation do not exceed the substantial costs involved. The fact that Australia is ‘ahead’ of the rest of the world is a matter of significant concern to the Committee, particularly in the light of the Commonwealth...
Government’s current commitment to achieve convergence of Australian accounting standards with international standards;

- given the Australian Accounting Standards Board’s recent decision not to require the valuation of land under roads until there is greater international convergence, the Committee is of the view that the Board should also re-examine the current requirement to value ‘stewardship’ land (e.g. national parks and reserves). The Committee believes that many of the arguments against the valuation of land under roads also apply equally to the valuation of ‘stewardship’ land;

- to address agencies’ concern about the potential of the public misinterpreting the financial value of cultural and heritage collections the Committee sees a need to provide a suitable explanation in the annual financial statements;

- with the recent change of the valuation basis from deprival value to fair value as required by accounting standards, there is an urgent need for the Australian Accounting Standards Board to provide guidance on the full implications of the change and on other related issues;

- the Department of Treasury and Finance needs to develop a comprehensive Asset Valuation Implementation Strategy focused on providing policy guidance, training and support to agencies as well as facilitating the exchange of knowledge and experience among agencies. This will ensure that a more consistent, reliable and cost-effective approach is applied across the Victorian Public Sector;

- the Committees concluded view is that there is room for further improvement in the whole area of integrated asset management. To take agencies to the best practice position will require a concentrated effort across the public sector. The Committee believes that the migration strategy should contain three key elements involving the establishment of a whole-of-government policy framework; the dedication of adequate resources and
priority by agencies; and the full integration of agencies’ asset management systems with their accounting and planning systems; and

- cultural institutions should work closely together in future in resolving practical valuation issues; formulating a model collection development and management policy; and identifying ways to maximise the management benefits of the valuation process.

The following recommendations have been developed by the Committee to address the key issues and concerns identified by the Inquiry.

**RECOMMENDATIONS**

*Chapter 2: Reporting of Cultural, Heritage and Infrastructure Assets*

The Committee recommends that:

Recommendation 2.1

(a) The following definition of cultural and heritage assets be adopted for the purpose of the stewardship reporting regime:

‘Those non-current physical assets that the State intends to preserve because of their unique historical, cultural or environmental attributes. These assets include items such as the Royal Botanical Gardens, Herbarium, State Library, Government House, Parliament House, historic houses, monuments, certain museum exhibits, art collections, library collections, archival collections and other items of cultural significance’; and

(b) The Auditor-General determine whether:
part or all of the assets of an agency are within the scope of the definition and therefore should be subject to the stewardship reporting regime applicable to ‘cultural and heritage assets’.

Recommendation 2.2

The following stewardship information be included in the notes to the annual financial statements of those agencies that hold cultural and heritage collection assets and other cultural and heritage assets:

(a) the quantum, nature and functions of the assets and, where applicable, their cultural and heritage significance;
(b) the non-financial benefits of the assets to the community;
(c) arrangements for public access and use;
(d) restrictions on the agency’s use and disposal of the assets;
(e) the current physical condition and age (where appropriate) of the assets;
(f) the conservation and preservation policies of the agency;
(g) an estimate of the annual costs of maintenance or preservation, where applicable;
(h) the accounting policies that apply to the valuation of the assets;
(i) details of significant changes to the assets during the financial year;
(j) expenditures on new assets and donations and bequests received during the financial year;
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(k) the proceeds of any sales of the assets in the financial year and how the proceeds were used; and

(l) a mix of qualitative and quantitative measures of performance in managing the assets, focusing on different operational aspects such as conservation, maintenance, acquisition, disposal and access.

Recommendation 2.3

Agencies be required to include, in a note to the annual financial statements, the following information on the management of the infrastructure and other physical assets (excluding cultural and heritage assets) under their control:

(a) the nature, functions, quantum and monetary value of each major category of assets;

(b) a brief outline of the policies adopted to manage the acquisition, operation, maintenance and disposal of the assets;

(c) an indication of the major risks associated with the operation of the assets and how the risks are controlled;

(d) details of major assets acquired or disposed of during the financial year;

(e) total amount of maintenance expenditure incurred during the financial year as compared to the planned expenditure under the Asset Maintenance Plan;

(f) where applicable, total amount of backlog maintenance expenditure, reasons for the delay in undertaking the maintenance work as planned and
projected timetable for the completion of the work;

(g) key performance indicators used to monitor and report on the operational performance of the assets together with details of actual performance against targets for the current financial year as well as the results of the previous years (i.e. trend data); and

(h) details of major initiatives implemented during the financial year to improve the operational performance of the assets.

Recommendation 2.4

The stewardship information detailed in Recommendations 2.2, 2.3 and 6.2 be subject to audit by the Auditor-General as to its appropriateness, relevance and accuracy.

Recommendation 2.5

The Department of Treasury and Finance forward a submission to the Australian Accounting Standards Board requesting a re-examination of the requirement for public sector agencies to ascribe a value to collection assets for financial reporting purposes taking into account:

(a) the approaches currently adopted in other major countries; and

(b) the Commonwealth Government’s commitment to achieve convergence of Australian accounting standards with international standards.
Recommendation 2.6

The Australian Accounting Standards Board consult widely with constituents in the public sector when developing accounting standards so as to ensure that those standards fully meet the special requirements of the sector, particularly in relation to the issues of stewardship and accountability.

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Recommendation 2.7

An additional note be included in the annual financial statements of cultural institutions explaining the reasons (where applicable) why:

(a) most of the cultural and heritage collection assets generally are not available for sale and, therefore, the monetary amount of those assets should not be interpreted as being available to meet financial obligations; and

(b) the changes in asset values and the related depreciation expense are not necessarily within the total control of the agency.

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Chapter 3: Asset Valuation Approach

The Committee recommends that:

Recommendation 3.1

The Australian Accounting Standards Board issue practical guidance, as a matter of urgency, on the full implications of the change from the deprival value method of valuation to the ‘fair value’ method, and on other related issues such as the annual reassessment of the ‘fair value’ of assets.
and the relevance of the ‘highest and best use’ test in the context of public sector assets.

Recommendation 3.2

The Department of Treasury and Finance issue practical guidance to agencies on:
(a) the intent and objectives of the prescribed valuation methods;
(b) the application of the optimisation process to determine the optimised depreciated replacement cost for infrastructure assets;
(c) the valuation of road and bridge infrastructure;
(d) the appropriate accounting treatment for determining items to be capitalised or charged as maintenance (for example, periodic resealing of roads);
(e) the application of the recoverable amount test to those commercial agencies that are subject to price control or receive community service obligation payments from the Government;
(f) the valuation approach to be adopted for those cultural or heritage assets that are difficult to value in a reliable manner;
(g) the application of sampling methods to asset valuation (including the valuation of collection assets); and
(h) the determination of the replacement cost for collection assets, including whether the preparation and documentation costs should be added to the re-collection costs.
Recommendation 3.3

Agencies dedicate adequate resources and priority to improving the management of assets on a whole-of-life basis and to better integrating the asset management systems with the corporate and business plans and also to the accounting systems.

Recommendation 3.4

A particular agency within the Victorian public service, for example, the Department of Infrastructure, be given responsibility to provide ongoing practical advice and assistance to other agencies on asset management issues, subject to the oversight of the Department of Treasury and Finance.

Recommendation 3.5

The Department of Treasury and Finance develop an Asset Valuation Implementation Strategy to provide practical guidance, training and support to agencies, as well as facilitating the sharing of information and experience across the public sector.

Chapter 4: Depreciation of Cultural, Heritage and Infrastructure Assets

The Committee recommends that:

Recommendation 4.1

The Department of Treasury and Finance:
(a) provide further detailed practical guidance to agencies on depreciation methods; and
(b) facilitate the exchange of information across agencies so benchmarking of depreciation practices within specific sectors can be established.

Recommendation 4.2
The accounting approach to depreciation be fully integrated into the asset management processes of agencies.

Recommendation 4.3
A whole-of-government approach be applied to improve the asset management systems of agencies and to facilitate agencies’ migration to best practice.

Recommendation 4.4
(a) The Department of Treasury and Finance establish clear guidelines on how depreciation and maintenance expenses are to be determined by agencies for accounting, budgeting and pricing purposes; and
(b) The Auditor-General’s Office continue to apply a rigorous approach when undertaking a financial statement audit on depreciation and maintenance.

Chapter 5: Cost and Reliability of Asset Valuation
The Committee recommends that:
Recommendation 5.1

Agencies establish formal arrangements, with the assistance of the Department of Treasury and Finance, to facilitate:

(a) the sharing of knowledge, experience and information on valuation methods across the public sector; and
(b) the development of cost-minimisation techniques for future valuations.

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Recommendation 5.2

The experience of those cultural institutions that have derived significant management benefits from asset valuation be shared with other institutions with a view to maximising the return from the expenditures incurred.

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Recommendation 5.3

The cultural institutions work together to formulate a best practice policy framework on collection development and management so that it can be used as a template for adaptation to the specific requirements of each institution.

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Recommendation 5.4

Agencies and valuers co-operate to develop, if possible, rigorous and consistent methods to obtain reliable valuations of certain categories of cultural and heritage assets.

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Recommendation 5.5

An independent expert valuer confirm, by certificate, an agency’s opinion that a
particular category of cultural or heritage assets is not capable of reliable valuation.

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Chapter 6: Reporting Practices in Major Overseas Countries

The Committee recommends that:

Recommendation 6.1
The Australian Accounting Standards Board be requested to re-examine, under the international convergence initiative, the current Australian requirement for public sector agencies to value ‘stewardship land’, including national parks and reserves and other Crown land.

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Recommendation 6.2
Those agencies holding ‘stewardship land’ be required to include additional stewardship information in the annual financial statements covering such matters as the quantum and condition of the land assets, details of maintenance and preservation work and associated costs.

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1.1 Background to the Inquiry

Victorian public sector agencies control a large and varied portfolio of assets, and the management of these assets is one of the major responsibilities of Government. Over the last ten years, successive Governments have implemented a wide range of economic, financial management and accountability reforms including accrual accounting, output budgeting and control, total resource management, compulsory competitive tendering, corporatisation and National Competition Policy. These reforms are primarily directed at achieving greater efficiency and effectiveness of operations; better value-for-money in service delivery; and an increased level of accountability and transparency in public sector administration.

In general, the Public Accounts and Estimates Committee considers that the availability of accurate and reliable information on the nature and value of assets and the cost of using the assets in service delivery is essential for making decisions about resource management and the funding and pricing of outputs. Further, agencies are accountable for managing their asset base in an effective manner. In fact, these were included in the key policy aims which underpinned the introduction of accrual accounting into the Victorian public sector in the mid 1990s.

If assets are not properly managed, this will have an adverse impact on the financial and budgetary position of the State and could be a major drain on its finances. Moreover, the application of ‘user pays’ and ‘purchaser/provider’ service delivery models also requires many public sector agencies to operate under a full-cost pricing regime, which includes depreciation and maintenance expenses.

Most of the State’s asset base comprises cultural, heritage and infrastructure assets. As at 30 June 2001, the total value of all these assets was about $60 billion.\(^4\) Infrastructure assets are used in the

\(^4\) Department of Treasury and Finance, 2000-01 Financial Report for the State of Victoria, pp. 88-92
production of essential services or products, and normally form part of a complex system or network of individual assets. These assets are of high value and have long useful lives. They are specialised in nature and often do not have alternative uses. Examples are water storage and supply systems, sewerage systems, public transport assets and road networks. Administration buildings also are part of the infrastructure of the State.

Alternatively, the Government retains cultural and heritage assets for their unique historical, cultural or environmental attributes. These assets assist the agencies that hold them to meet objectives in terms of exhibition, education, research and preservation, all of which are directed at providing a cultural service to the community. Examples of such assets are museum, library, art and archival collections as well as botanical gardens, Parliament House, Government House, historic houses and other items of cultural significance.

In the past, the Auditor-General had qualified the annual financial statements of some of the State’s cultural institutions because their Statements of Financial Position did not include an ascribed valuation for the cultural and heritage assets held.

Initially, some institutions were reluctant to undertake the valuation exercise. Further, they encountered practical difficulties in valuing certain categories of asset. Eventually, those institutions accepted that they had no alternative but to value the assets as it was a requirement of the accounting standards and Government policy. At that time, the then Auditor-General’s view on this issue was quite clear. He considered the assets to be significant, consuming large amounts of scarce public resources in their acquisition and maintenance, and that to omit them from the annual financial statements would remove a significant segment of public sector resources from external scrutiny.5

The quantum of cultural, heritage and infrastructure assets managed by the public sector represents a significant component of the State’s entire asset base. Therefore, the accounting treatments applied to these assets can have a major impact on the

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reported financial results and position of an agency. A number of Australian Accounting Standards (AAS’s) relate to the treatment of these assets, including:

- AAS 29 ‘Financial Reporting by Government Departments’ and AAS 27 ‘Financial Reporting by Local Governments’ are the two main accounting standards which require recognition in the Statement of Financial Position of all assets, including cultural, heritage and infrastructure assets, if it is probable that the future economic benefits (that is, service potential) embodied in the asset will eventuate and if the asset possesses a cost or other value that can be reliably measured;
- AAS 4 ‘Depreciation of Non-Current Assets’ which requires that all assets with limited useful lives be subject to depreciation; and
- AAS 1041 ‘Revaluation of Non-Current Assets’ which sets out the methods for determining the current values of assets and also the requirements for periodically revaluing assets to ensure the values are up-to-date.

In addition, the Department of Treasury and Finance has issued policy and guideline documents on asset recognition and valuation by Departments and public bodies, elaborating on the Government’s requirements within the context of the accounting standards. These policies and guidelines do not differentiate between cultural and heritage assets and other infrastructure assets held by agencies.

Although all agencies within the Victorian public sector have now valued their assets as required by accounting standards and Government policy, the Committee has noted some remaining concerns about (a) the appropriateness of certain aspects of the standards and, (b) the implementation of those standards within the public sector. The Committee decided, therefore, in early 2000 to undertake an Inquiry as a forum to publicly canvass the issues of concern and also to review the valuation experience of agencies as a post-implementation assessment. The aim was to formulate a proposed action plan, not only to resolve the issues but also to
maximise the use of asset valuation information for the benefit of agencies and the Government as a whole.

The Committee’s background research revealed that the debate about valuation seemed to centre on the following matters:

**Infrastructure Assets**

- whether the valuation and depreciation of these assets in accordance with the accounting standards have any adverse effects on (a) the quality of the financial information provided to internal asset managers, and (b) the financial monitoring and operational management processes (for example, assessing financial performance and position of agencies and identifying the full cost of service delivery in line with commercial principles);

- whether depreciation methods that comply with the accounting standards are compatible with, or appropriate for, infrastructure assets that have the following characteristics:
  - very long useful lives that are difficult to estimate and where a small revision in that estimation can have a major impact on the operating results; and
  - expenditures on maintenance, as distinct from asset enhancements, that are difficult to identify; and

- whether alternative approaches to depreciation of long-lived assets can be adopted to satisfy the internal asset management and reporting requirements of an agency as well as the external reporting requirements of AAS 4.

**Cultural and Heritage Assets**

- whether cultural and heritage assets satisfy the asset definition and recognition criteria contained in the accounting standards;

- whether the inclusion of these assets, using valuation methods that may not be reliable, will satisfy the information needs of general purpose financial report users;
• whether any benefits from valuing and incorporating these assets into financial statements justify the cost of obtaining the valuations;

• whether the reporting requirements in Victoria are consistent with those of other countries such as the United States, Canada and OECD members; and

• whether there is a need to review the methods by which some cultural and heritage asset categories are valued, so as to improve the reliability of the results obtained.

1.2 Scope of the Inquiry

The Committee’s terms of reference for the Inquiry were to:

• determine whether the characteristics shown by cultural, heritage and infrastructure assets, or categories of those assets, satisfy the asset recognition criteria contained in AAS 27 and AAS 29;

• assess the current valuation methods for cultural, heritage and infrastructure assets in terms of meeting the financial and operational requirements of Government agencies and satisfying external reporting requirements;

• determine whether the depreciation methods required by the accounting standards are compatible with, or appropriate for, cultural, heritage and infrastructure assets owned by the Victorian Government;

• examine the costs of obtaining valuations, particularly of cultural and heritage assets, and determine whether the reliability of the valuation justifies the cost;

• identify the reporting requirements of cultural, heritage and infrastructure assets in overseas countries such as the United States, Canada and OECD members, and determine the need for alternative valuation methods in Australia; and

• determine what changes are necessary to ensure a consistent and reliable valuation and reporting mechanism for cultural, heritage and infrastructure assets.
1.3 Inquiry process

The Committee appointed the following Sub-Committee for this Inquiry:

Hon. R Hallam, MLC (Chairman);  
Mr T Holding, MP;  
Mr P Loney, MP;  
Mrs J Maddigan, MP; and  
Hon. G Rich-Phillips, MLC.

The terms of reference for the Inquiry were advertised in The Age and The Australian newspapers on 1 April 2000. Given the significant amount of literature that has been written on the accounting treatment of infrastructure, cultural and collection assets, the Committee did not consider that developing an issues paper was necessary. The Committee received 33 submissions (listed in Appendix 1).

Evidence was taken from 40 witnesses during public hearings held in Melbourne between October 2000 and April 2001. Appendix 2 lists the individuals and organisations that gave evidence at the hearings. The Committee thanks all those who participated in the Inquiry by appearing as witnesses and/or providing written submissions. The work of the Committee is greatly assisted by such community-wide participation.

In examining the issues identified in the terms of reference, the Committee also reviewed the accounting policies and practices of other Australian jurisdictions, particularly the Commonwealth and New South Wales Governments. Further information and comments were received from the Department of Treasury and Finance, the Victorian Auditor-General’s Office, the Victorian Valuer-General’s Office and the Australian Accounting Standards Board.

1.4 Focus of the Inquiry

The Committee is aware that agencies, in the early stages of implementing accrual accounting, had to devote significant resources to resolving the practical issues of asset valuation and depreciation. The Department of Treasury and Finance provided a
high-level policy framework, but the actual implementation was left to the individual agencies. Those agencies with complex assets generally had to seek the advice and assistance of outside experts, for example, professional valuers.

The Committee was advised that there were inadequate arrangements for sharing knowledge and experience among agencies and for ensuring a consistent and co-ordinated approach was adopted across the public sector. The Committee has no doubt that the cost and quality of the valuations were affected as a result.

To accommodate the difficulties faced by public sector agencies during the implementation process, the accounting standard-setters acted to amend the relevant accounting standards, including the provision of transitional periods. They also gave specific guidance on certain issues, such as how to treat capital and maintenance expenditures and depreciation (including condition-based depreciation). The Committee was advised that the Australian Accounting Standards Board has a policy to regularly review the application of standards and to obtain feedback from its constituents through, for example, the various consultative groups.

The Committee considers that progressive refinement in recent years has settled the broad accounting rules and Government policies on asset valuation and depreciation. However, the Australian Accounting Standards Board has indicated to the Committee that it would be receptive to suggested amendments if certain rules are seen to be inappropriate for the public sector.

Following the recent introduction of a new accounting standard AASB 1041 ‘Revaluation of Non-Current Assets’, clarification is now urgently needed from the Australian Accounting Standards Board as to the full implications of the adoption of the ‘fair value’ basis of valuation as required by the standard. At present, the current values of the assets held by agencies have been derived using the ‘deprival value’ method. Pending advice from the Board, the Department of Treasury and Finance has instructed agencies to continue to use ‘deprival values’ as surrogates for ‘fair values’. The Committee understands that a similar position has also been adopted by other Australian jurisdictions.
In conducting the Inquiry, the focus of the Committee was on:

- determining whether any aspects of the existing accounting standards or Government policies require further clarification or amendment;
- identifying unresolved issues relating to asset valuation and depreciation, along with appropriate mechanisms for resolving those issues;
- identifying where the Department of Treasury and Finance and/or the Australian Accounting Standards Board must provide further practical guidance and assistance;
- developing proposals for how agencies could make their future valuation processes more reliable, consistent and cost-effective;
- formulating ways in which the valuation and depreciation information can be better used for total asset management, budgeting and pricing decisions; and
- developing a supplementary stewardship reporting regime (for both cultural, heritage and infrastructure assets) to better explain the performance of agencies in managing the assets under their control.

The following chapters discuss the Committee’s findings on the key issues under the terms of reference.
Key Findings:

2.1 Generally, agencies do not have any disagreement with the recognition of infrastructure assets in the annual financial statements.

2.2 However, a number of cultural institutions and academic commentators consider that most of the cultural and heritage assets should not be recognised. They argue that these assets do not meet the definition of, and recognition criteria for, ‘assets’. They justify this view by pointing to the inability of cultural and heritage assets to generate net cash inflows and to the ‘special’ characteristics of these assets.

2.3 The accounting standards are clear that cultural and heritage assets, despite their ‘special’ characteristics, normally satisfy the requirements for recognition in the financial statements. The Department of Treasury and Finance, the Victorian Auditor-General’s Office and most agencies in Victoria share this view.

2.4 The experience of agencies indicates that rarely would an agency be unable to obtain a reliable value for cultural, heritage and infrastructure assets based on the valuation model commonly adopted across Australia. However, they also acknowledge that practical problems and inconsistent approaches still exist in the valuation of certain types of cultural, heritage and infrastructure assets.

2.5 In relation to heritage and cultural collections, the Committee has noted that Australia and New Zealand are the only two countries in the world that have imposed a mandatory requirement for their valuation by Government agencies. At present, valuation is not
compulsory in the United States, Canada and the United Kingdom nor under

Key findings (continued):

the International Public Sector Accounting Standards. However, the Public Sector Committee of the International Federation of Accountants has indicated that it plans to further examine issues relating to the valuation of heritage assets in the near future.

2.6 Currently, there is a move within Australia to adopt International Accounting Standards for both the private and public sectors as part of the international convergence initiative of the standard-setting body. In light of these developments, the Committee believes that the Department of Treasury and Finance should request the Australian Accounting Standards Board to undertake a re-examination of the requirement for public sector agencies to ascribe a value to collection assets for financial reporting purposes. The review should take into account the approaches currently adopted in other major countries and also the Commonwealth Government’s commitment to achieve convergence of Australian accounting standards with international standards.

2.7 In order to further enhance accountability for the management of cultural and heritage (including collection) assets, the Committee believes that there is a strong case for all cultural institutions to adopt a supplementary ‘stewardship’ reporting regime to augment the existing financial reporting framework.

2.8 Further, the Committee is of the view that a separate stewardship reporting regime should be introduced requiring all agencies to report on their performance in managing the infrastructure and other physical assets (excluding cultural and heritage assets) under their control.
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2.9 To ensure the integrity and reliability of the stewardship information (including key performance indicators) published by agencies, it is essential that the additional disclosures be subject to audit by the Auditor-General in line with the practices in some of the other Australian jurisdictions and overseas countries.

2.1 Introduction

A threshold issue that the Committee set out to examine was whether the characteristics shown by cultural, heritage and infrastructure assets (or categories of those assets) meet the definition of ‘assets’ and the recognition criteria contained in the accounting standards. Australian Accounting Standards AAS 27 ‘Financial Reporting by Local Governments’, AAS 29 ‘Financial Reporting by Government Departments’ and AAS 31 ‘Financial Reporting by Governments’ require recognition in the financial statements of all assets that meet the definition of, and recognition criteria for, ‘assets’ (term of reference No. 1).

Although public sector agencies in Victoria now include all assets under their control in the annual financial statements as required by accounting standards and Government policy, a number of cultural institutions consider that most of the cultural and heritage assets should not be recognised. Some academic commentators share this view. As at 30 June 2001, the total value of all cultural and heritage assets held by agencies was $1,242 million.\(^6\)

The Committee was interested in ascertaining the basis for the concerns and determining whether the Australian Accounting Standards Board should revisit the ‘asset’ definition and recognition criteria in relation to their application to the public sector. The submissions received indicate that agencies in Victoria generally do not disagree with the recognition of infrastructure assets in the financial statements.

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To qualify for inclusion in the financial statements, the assets must meet two separate tests: the definition of ‘assets’ and the recognition criteria for ‘assets’.

2.2 Definition of ‘assets’

‘Assets’ are defined in AAS 27, AAS 29, AAS 31 and the Statement of Accounting Concepts (SAC) No. 4 ‘Definition and Recognition of Elements of Financial Statements’ as:

… future economic benefits controlled by the entity as a result of past transactions or other past events.

This definition identifies three essential characteristics that an asset must possess to qualify as an asset of an entity for financial reporting purposes:

- it must represent future economic benefits;
- it must be controlled by the entity; and
- the entity’s control over the future economic benefits must have resulted from past transactions or other past events.

Some submissions and witnesses at public hearings argued that most cultural and heritage assets do not satisfy the definition of ‘assets’ because they do not embody financially quantifiable future economic benefits. They contended that the assets’ characteristics and the operating objectives of the controlling agencies would often mean that the assets do not generate net cash inflows, either through their use in service delivery or from their sale in the marketplace. This view was based on the interpretation of ‘future economic benefits’ as equating to net cash inflows. The Committee has been informed that this narrow interpretation was clearly not intended by the accounting standard-setters in Australia.

The definition of ‘assets’ contained in the three accounting standards referred to earlier was derived from SAC 4. The Committee understands that the accounting concepts embodied in

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7 For example, Mr R. Llewellyn, Project Manager for the valuation of all NSW cultural collections, with the exception of the Art Gallery, submission no. 14, p. 1
8 For example, Mr G. Newcombe, General Manager, National Galley of Victoria on Russell, transcript of evidence, p. 48 and Ms L. McAllister, Research Officer, Royal Botanic Gardens, transcript of evidence, p. 55
SAC 4 are consistent with those adopted by the United States, Canada and the United Kingdom, as well as the International Accounting Standards Board. SAC 4 describes future economic benefits as:

... The scarce capacity to provide benefits to the entities that use them, and is common to all assets irrespective of their physical or other form. In pursuing their objectives, both profit-seeking and not-for-profit entities provide goods and services that have the capacity to satisfy human wants and needs. Both types of entity create utility and value in essentially the same way – by using assets to provide goods and services that their customers or beneficiaries desire or need. (SAC 4 paragraph 18)

SAC 4 makes it quite clear that the economic benefits can be provided to an entity in a form other than net cash inflows:

The fact that not-for-profit entities do not charge, or do not charge fully, their beneficiaries or customers for the goods and services they provide does not deprive these outputs of utility or value; nor does it preclude the entities from benefiting from the assets used to provide the goods and services. For example, assets such as monuments, museums, cathedrals and historical treasures provide needed or desired services to beneficiaries, typically at little or no direct cost to the beneficiaries. These assets benefit the entities by enabling them to meet their objectives of providing needed services to beneficiaries. (SAC 4 paragraph 21).

Mr Graeme Addicott of the Australian Valuation Office (Darwin Region) mentioned in his submission that a normal way of determining whether a particular cultural or heritage asset can contribute to the objectives of a cultural institution is to assess the item with reference to the acquisition (or accession) policies of the Institution.\(^9\)

In Australia, the accounting standard-setters clearly adopt the view that the generation of net cash inflows is not a necessary condition for an item to qualify as an ‘asset’ for financial reporting purposes. Therefore, the inability of cultural, heritage and infrastructure assets to generate net cash inflows for the public

\(^9\) Mr G. Addicott, submission no. 30, p. 8
sector agency that controls them should not preclude them from meeting the definition of ‘assets’. In other words, if the assets are capable of producing public benefits that flow to the community, then they should be included in the financial statements.

A number of submissions and witnesses argued that, if only those assets that generate net cash inflows are considered to meet the definition of ‘assets’, then all the resources controlled by Government Departments and other non-profit agencies would not have to be reported and subject to scrutiny. This is clearly an unacceptable outcome from a Government policy perspective.

SAC 4 specifically states that the inability of an agency to impose charges on the public use of an asset or to achieve full cost recovery for the use of the asset does not mean that the agency cannot derive economic benefits from using the asset. Under SAC 4, an economic benefit is considered to have been derived by a non-profit making agency if the asset has assisted the agency in achieving its operational objectives. In other words, the benefit can be in a form other than net cash inflows.

The concept of ‘control’, which is central to the definition of an ‘asset’ in accounting standards, is defined in SAC 4 as:

\[
\ldots\text{The capacity of the entity to benefit from the asset in pursuit of the entity’s objectives and to deny or regulate the access of others to that benefit. (SAC 4 paragraph 14)}\]

The concept is explained in detail in SAC 4, making it clear that the inability to sell or modify an asset does not preclude an entity from benefiting from the service potential embodied in the asset. While an agency may be unable to sell a cultural collection or an infrastructure asset, or use it for any other purpose, these limitations or restrictions generally do not inhibit the asset’s contribution to the agency’s achievement of its objectives.

SAC 4 explains that an ability to retain the proceeds from sale is not a key determination of control in the public sector. For those public sector assets that are subject to certain restrictions in their use and/or disposal, the accounting standards do not prohibit their inclusion but require them to be separately identified and explained in the financial statements, including details of the restrictions.
Legal ownership also is not a necessary pre-requisite in assuming control of an asset. The Crown owns all assets held by Departments and their agencies.

Under SAC 4, it is not the ability to restrict public access that is relevant, but rather the ability to deny the use of the assets by other entities for any alternative objectives. For example, a museum is considered to have control of the collection assets if it can deny another agency or entity from changing public access rights to those assets for a different objective, such as increased academic research for private fee-paying clients.\(^\text{10}\)

The definition of ‘assets’ also refers to ‘control’ of an asset having been acquired as a result of ‘past transactions or other past events’. It seeks to distinguish between future economic benefits that are presently controlled and those that may be controlled in the future. Cultural, heritage and infrastructure assets that public sector agencies hold now as a result of a past transaction or other event, such as a formal administrative arrangement, meet this criterion.

### 2.3 Recognition criteria for ‘assets’

AAS 27, AAS 29 and AAS 31 contain the following asset recognition criteria:

\[\text{An asset should be recognised in the statement of financial position when, and only when:}\]

\[(a) \text{ it is probable that the future economic benefits embodied in the asset will eventuate; and}\]

\[(b) \text{ the asset possesses a cost or other value that can be measured reliably.}\]

For an asset to qualify for recognition under the accounting standards, it must be probable (more likely than not) that the agency can benefit from the future economic benefits embodied in the asset. Some witnesses argued that the future economic benefits embodied in some cultural, heritage and infrastructure assets are not immediately evident or that the benefits do not flow directly to the public sector agency.

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\(^{10}\) Department of Treasury and Finance, submission no. 32, p. 9
For example, an agency may hold and maintain certain cultural and heritage assets for their cultural and historical interest. In these cases, the witnesses argued that the benefits of these assets flow to the community as a whole, or a section of the community, rather than directly to the agency. However, both AAS 27 and AAS 29 adopt the view that the agency is able to enjoy the benefits embodied in the assets because they are part of the means by which the agency is able to achieve its service delivery objectives. These objectives include preservation, exhibition, education and research.

For an asset to be recognised in the financial statements, it also must have a cost or other value that can be reliably measured. Most cultural, heritage and infrastructure assets have been acquired at a cost, but the accounting standards recognise that some agencies may not have adequate records to substantiate the cost figures. The absence of a cost-based measure of an asset should not preclude its recognition. In such cases, AAS 27 and AAS 29 require that the agency determine a value for the asset.

The experience of public sector agencies across Australia indicates that rarely would an agency be unable to obtain a reliable value for cultural, heritage and infrastructure assets based on the valuation model commonly adopted and endorsed by the valuation profession. However, it is recognised that practical problems and inconsistent approaches exist in relation to the valuation of some cultural, heritage and infrastructure assets.

During the Inquiry, a number of cultural institutions conveyed to the Committee their concerns about the accuracy and reliability of some of the valuation figures obtained, despite the valuations having been signed off by expert valuers and accepted by the Auditor-General. In those cases where a reliable value cannot be determined for an asset, the accounting standards require certain details relating to the unrecognised asset to be included in the notes to the financial statements. Confirmation that a reliable value cannot be obtained is normally provided by an independent expert valuer and the Auditor-General’s Office.

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11 For example, Mr. G. Newcombe, General Manager National Gallery of Victoria on Russell, pp. 48-49
Both AAS 27 and AAS 29 are clear that cultural, heritage and infrastructure assets normally meet the definition of ‘assets’ and the recognition criteria. The accounting standard-setters’ view is that the ‘special’ characteristics of those assets should not preclude them from being included in the financial statements. The two standards even refer to specific types of infrastructure and heritage assets as examples of assets that should be included in the financial statements if they meet the recognition criteria. For other public sector agencies that are not Departments or Local Government bodies, AAS 4 ‘Depreciation’ specifies similar recognition criteria for assets with physical substance.

To allow agencies sufficient time to undertake the valuation process and to set up the necessary asset management and accounting systems, both AAS 27 and AAS 29 provided for lengthy transitional – that is, implementation – periods.

The Committee notes that AAS 29 provides a brief overview of the accounting standard-setters’ rationale for requiring the inclusion of all assets (including cultural, heritage and infrastructure assets, without exceptions) in the financial statements:

Government Departments are created to provide goods and services consistent with Government policies. The objective of general purpose financial reporting is to disclose information for economic decision-making, including information which will assist in the discharge of accountability obligations. For these purposes, users are likely to require information about the resources controlled by the Government Department, changes in those resources as a result of the reporting period’s operations and the Government Department’s performance in using those resources for the achievement of its objectives. The recognition of assets in the statement of financial position results in users being informed of the amount and types of future economic benefits deployed by the Government Department to meet its service delivery objectives. This information, together with information about liabilities, revenues, expenses and cash flows, is useful for assessing the Government Department’s ability to continue to provide goods and services at a given level, and the level of resources that may need to be provided to the Government Department in the future so that it may continue to provide goods and services.
Accordingly, this Standard requires all assets that satisfy the asset recognition criteria to be recognised in the statement of financial position, including the following:

(a) infrastructure assets, for example, transport systems
(b) heritage assets, for example, historical buildings and monuments
(c) community assets, for example, parks and recreational reserves
(d) other assets which provide services or economic benefits over long periods of time, for example, buildings and items of plant and equipment.

(AAS 29 paragraph 7.1.1)

2.4 Views on the recognition of assets

The issue of the recognition of ‘assets’ (particularly cultural and heritage assets) dominated the comments made by witnesses at the public hearings and also in the submissions received. The Australian Accounting Standards Board, the Department of Treasury and Finance, the Auditor-General’s Office and most agencies noted that all public sector assets should be recognised, with no exceptions. Some of the cultural institutions and a number of academic commentators, on the other hand, considered that cultural and heritage assets should be exempt from recognition in the Statement of Financial Position because those assets have special characteristics. For accountability purposes, a few suggested that a supplementary stewardship reporting regime should be established for this particular category of assets.

When questioned about the requirement to include a monetary value for cultural and heritage assets in the Statement of Financial Position, Mr Keith Alfredson, the Chairman of the Australian Accounting Standards Board, advised:

… I think if the general public was told that [an] art gallery has art worth $1 billion and this one has $3 billion worth of art, it focuses the mind. The real level of accountability is only visual when you express it that way. For example, I do not think there is any point in doing a balance sheet of an art gallery that shows the buildings and the bits of furniture if it does not show
the contents. That is what the board of directors or the councillors are responsible for managing.\textsuperscript{12}

However, Mr Keith Alfredson also acknowledged some unresolved practical issues in asset valuation:

\textit{I do not deny that there are problems in valuation, but I say to myself what is the alternative – no value in the balance sheet, or don’t tell the public that we have $10 billion worth of art in this art gallery?\textsuperscript{13}}

Mr Steve Gurr of the Department of Treasury and Finance advised the Committee that the Victorian Government is strongly committed to the adoption of the accounting standards for financial reporting as part of the Management Reform Program:

\textit{As part of the Management Reform Program and other management reforms what we are and have been for some time seeking to introduce in Victoria is that we are particularly concerned with full and frank reporting of the activities of Government to the community of Victoria in a way that is open, transparent and understandable to as many people as possible. It is for that reason that we are strongly committed to the use of generally accepted accounting principles, and in particular the Australian Accounting Standards.\textsuperscript{14}}

Mr Warren McGregor, Consultant and former Executive Director of the Australian Accounting Research Foundation pointed out that overseas counterparts of Australia’s accounting standard-setters share the view that cultural, heritage and infrastructure assets normally meet the definition and recognition requirements for ‘assets’:

\textit{But in the first case, the characteristics shown by heritage and infrastructure assets are such that we believe they would meet the recognition and definition characteristics of the requirements set out in the accounting standards and that is a view that I think is reflected in the approaches taken by a number of standard-setting bodies around the world at this}

\textsuperscript{12} Mr K. Alfredson, Chairman Australian Accounting Standards Board, transcript of evidence, p. 73
\textsuperscript{13} Ibid, p. 73
\textsuperscript{14} Mr S Gurr, Department of Treasury and Finance, transcript of evidence, p. 84
time, and is not a view limited to the standard-setters in this country.\textsuperscript{15}

Alternatively, Professor Gary Carnegie of Deakin University argued that cultural and heritage assets do not satisfy the definition of ‘assets’ because they cannot generate net cash inflows. He reiterated this view, shared by a number of cultural institutions, at a public hearing:

\textit{What we are saying is that if the asset is the future economic benefit, in the case of not-for-profit entities it falls over, because there is no positive net cash inflow to justify those things being recorded as assets. I think there is a very substantial and solid argument as to why not-for-profit organisations in general can fall by the wayside on this issue. It was all tied up with the definition of the asset.}\textsuperscript{16}

In a 1995 article, Professors Carnegie and Wolnizer also argued that Government agencies do not ‘control’ their cultural and heritage assets.\textsuperscript{17} ‘Control’ is one of the tests in the definition of ‘assets’. They gave the following reasons for the absence of control:

\begin{itemize}
  \item the agency is restricted in its use and disposal;
  \item the agency is unable to deny the public access to the assets; and
  \item the agency is restricted in its ability to exact a price for the public’s use of the assets.
\end{itemize}

Professor Graham Peirson (Monash University) and Mr Frank Micallef (Australian Accounting Research Foundation) wrote a detailed response to the issues raised by Professor Gary Carnegie and Professor Peter Wolnizer.\textsuperscript{18} The Committee understands that both the former and current Australian Accounting Standards Board endorse the views expressed in the Peirson and Micallef article, which claimed:

\begin{itemize}
  \item \textsuperscript{15} Mr W McGregor, Consultant and former Executive Director, Australian Accounting Research Foundation, transcript of evidence, p. 84
  \item \textsuperscript{16} Professor G Carnegie, transcript of evidence, p. 67
  \item \textsuperscript{17} Australian Accounting Review, Vol. 5, No. 1
  \item \textsuperscript{18} Australian Accounting Review, Vol. 7, No. 1
\end{itemize}
… that restrictions on an agency’s use of assets and on its ability to sell or otherwise dispose of the assets do not preclude it from benefiting from the assets in pursuing its objectives. Restrictions on the use of an asset compromise control only where they fundamentally affect the ability of the asset to assist the agency in achieving its objectives.

Further, the article pointed out that museums, art galleries and libraries are established to allow public access to their collections (and not, for example, to sell the collection assets at a profit). Therefore, an inability to sell assets does not compromise their utility to the entity.

The article also contended that the ability to deny or regulate the access of others to the assets’ benefits is not compromised by the inability to deny public access to view the collections (even though in many cases the public is denied access to a large part of the collections). Peirson and Micallef believed that this part of the control test should focus on the entity’s capacity to use the assets and to deny the use of the assets by other entities. In their view, evidence that this part of the control test is satisfied is indicated normally by the possession and use of an item by a museum, art gallery or library.

Finally, the article argued that whether a museum, for example, imposes charges on those viewing its collections does not affect control of the collection items. As the objectives of such entities do not encompass full cost recovery, any restrictions on the entities’ ability to impose a charge for public use of the assets is irrelevant and should not compromise the entities’ ability to use the assets to achieve their objectives.

Mr Greg Pound of the Victorian Auditor-General’s Office advised that the cultural, heritage and infrastructure assets of the Victorian public sector should be recognised and that the ability to generate net cash inflows is not a necessary test to satisfy the definition of ‘assets’:

AAS 27 and 29 make specific reference to the types of assets we are talking about, so the standards derived from the concepts statements explicitly recognise those assets as meeting the criteria. I do not think there is any question that they meet the
criteria. People might argue that the standards are good, bad or indifferent, but I do not think that is the issue. The standards are there, and the criteria they impose are quite clear.\textsuperscript{19}

Further, he noted that:

\textit{The other point I want to make on term of reference 1 is that some people have the view that, unless you have a cash flow resulting from an asset, you do not have an asset. I think it is clear in both the statements of accounting concepts and the accounting standards that you do not necessarily have to have an economic benefit in terms of cash flows for there to be an asset, and that resources that enable an entity to provide services represent a benefit.}\textsuperscript{20}

The notion of cultural and heritage assets providing a social benefit to the community, rather than a financial benefit to the controlling agency, was canvassed by Mr Martin Hallett of Museum Victoria in evidence to the Committee:

\textit{Most heritage assets are held in collections which have either legislation or memoranda of association which relate to the social benefit those collections offer the community rather than their financial value. If we take, for instance, Museum Victoria, there are clear indications in its legislation and strategic plan that collections are held in trust for the community.}\textsuperscript{21}

A number of accounting academics in Australia consider that certain public sector assets, particularly those used for community purposes and natural capital assets, should be accorded a different accounting treatment from that for conventional long-lived assets.\textsuperscript{22} First, they argue that the operating environment and information needs of the public sector are different from those of the private sector, which essentially is profit-seeking. Second, they argue that the nature of the following rights, which are normally attached to assets, is different in the public sector:

- the right to manage and make decisions about asset use;
- the right to the benefits arising from asset use; and

\textsuperscript{19} Mr G Pound, Victorian Auditor-General’s Office, transcript of evidence, p. 16
\textsuperscript{20} Ibid, p. 16
\textsuperscript{21} Mr M Hallett, Museum Victoria, transcript of evidence, p. 29
\textsuperscript{22} These matters are discussed in an article by Professor D Barton ‘A Trustee Theory of Accounting for Natural Capital Assets’, \textit{Abacus}, Vol. 35, No. 2, pp. 207-222
the right to dispose of the assets.

The academics’ view is that the assets owner possesses all three rights in commercial markets. However, in many public goods markets, the rights to benefits does not accrue to the Government as owner, but to the public. Further, the right to dispose of the asset is often severely restricted. Academics of this opinion argue that the obligations of Government agencies are to preserve and maintain the assets in good condition for social and environmental reasons. These assets cannot form part of the financial position of an agency because they do not produce future net cash inflows from the sale of its services and they cannot be sold.

In an article written by Ms Jennifer Byrne and published in The Age Magazine (7 September 2002), a number of interesting observations were made about the Government’s decision to assign a dollar value to the collection assets held by a cultural institution. These observations, in fact, reflected many of the views put to the Committee by a number of the cultural institutions and academic commentators:

… You could call it the triumph of the accountants. You could interpret it as an assault on the old museum culture. You could see it as an absurd waste of time and money, or as a sound management exercise, or as a way of boosting a state’s asset rating – it has been called all these things, and more. … It also makes you wonder about our times, and about our notions of value … It’s intriguing, the results can be amusing, and in the spirit of economic rationalism it may even be desirable to know the value of what we have. But does it make any sense? And, at a deeper level, does the assignment of dollar value not just confuse but actually diminish something’s true worth?

… The carrot was that once Government saw how valuable these collections really were – and what appalling conditions they were being kept in, with leaky ceilings and rising damp – they would pay more to protect and conserve them. The stick was that if museums continued to resist, the auditors would ‘qualify’ their annual accounts – that is, refuse to tick them off as valid and correct. Gradually, reluctantly the institutions fell into line.
Another major issue raised in the submissions and at the public hearings is the potential for the readers of the financial statements to be misled about the financial position and responsibility of an agency that has recognised cultural or heritage assets. Some Inquiry participants argued that readers could mistakenly have the impression that the assets are available for sale and therefore that the agency could use the sale funds to meet its financial obligations.\textsuperscript{23} The Committee has noted that both AAS 27 and AAS 29 have specific disclosure requirements relating to restricted assets.

A further issue raised during the Inquiry is the fact that changes in asset values and depreciation expense could have an impact on the financial position and operating results of an agency. The concern is that these two factors are, largely, beyond the control of the agency and, therefore, it is unreasonable for the agency to be held accountable for the accounting outcomes.

### 2.5 International accounting standards approach

At present, the international convergence of accounting standards has become the top priority for the private sector standard-setters around the world. The convergence process involves all countries adopting the same set of accounting standards developed by the International Accounting Standards Board (IASB). In Australia, the Financial Reporting Council recently made an announcement that all companies will be required to comply with IASB (rather than Australian) standards for reporting periods beginning on or after 1 January 2005. The Council is a Commonwealth Government body established to oversee the setting of accounting standards in Australia for both the private and public sectors.

In light of the Council’s announcement, the Australian Accounting Standards Board decided, at the August 2002 meeting, the following:

- it should continue to issue one series of sector-neutral standards, that is, standards applicable to both for-profit (e.g. corporate) and not-for-profit (e.g. public sector) entities;

\textsuperscript{23} For example Museum Victoria, submission no. 16, p. 7
• except for standards peculiar to the not-for-profit or public sectors or that are purely of a domestic nature, IASB standards should be used as the ‘foundation’ standards to which it would add material detailing the scope and applicability of the standard in the Australian environment and any other statements dealing with local requirements; and

• it should consider the role of the International Public Sector Accounting Standards issued by the Public Sector Committee of the International Federation of Accountants (IFAC) as part of the convergence initiative.

It is envisaged that the Australian Accounting Standards Board will, from time to time, issue specific Australian standards for the public sector (for which there are no IASB counterparts) where considered appropriate and also will modify the scope of the application of IASB standards to that sector. However, such actions are expected to be infrequent.

At present, the Public Sector Committee of IFAC is in the process of issuing an initial series of accounting standards for adoption by the public sector around the world. This mirrors the convergence development in the private sector. The membership of IFAC is made up of 156 accounting bodies in 114 countries including Australia, New Zealand, the United States, Canada and the United Kingdom.

The Public Sector Committee recognises the significant benefits of achieving consistent and comparable financial information across jurisdictions and believes that the International Public Sector Accounting Standards will play a key role in enabling these benefits to be realised. It plans to review the initial standards over time to ensure they adequately address the specific issues relating to the public sector.

In implementing the convergence initiative for the public sector, the Committee has been advised that the Australian Accounting Standards Board is likely to adopt IASB standards as the foundation with any necessary modifications for the public sector to be based on the special requirements contained in the standards issued by the Public Sector Committee of IFAC. Given this, the
Committee is firmly of the view that the Victorian Government should maintain a close watch on the standards issued by the Public Sector Committee and be aware of any divergence from those standards in terms of the reporting requirements that are prescribed for the Victorian public sector.

In the case of the public sector in Australia, the accounting standards are developed by the Australian Accounting Standards Board but the application of those standards is mandated by specific legislation enacted by the individual Governments.

With respect to the valuation of assets, the Committee has noted that a new standard was issued by the Public Sector Committee in December 2001. IPSAS 17 requires all infrastructure assets to be recognised in the Statement of Financial Position. In the case of heritage assets (as defined in the standard), the Public Sector Committee considers that they generally satisfy the definition of ‘assets’ but that recognition should not be mandatory at this stage. This means that member countries of IFAC can either recognise heritage assets, along with all other assets, or omit them from the financial statements.

The Committee has been advised that the decision of the Public Sector Committee in relation to heritage assets is a holding position. The main aim is to allow itself more time to consider the measurement of heritage assets, particularly the development of reliable valuation methods that are generally acceptable to member countries of IFAC.

IPSAS 17 includes a lengthy, five years transitional period to allow member countries to value their assets progressively and bring them onto the financial statements.

IPSAS 17 makes the following comments on heritage assets:

Some assets are described as ‘heritage assets’ because of their cultural, environmental or historical significance. Examples of heritage assets include historical buildings and monuments, archaeological sites, conservation areas and nature reserves, and works of art. Certain characteristics, including the following, are often displayed by heritage assets (although these characteristics are not exclusive to such assets):
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(a) their value in cultural, environmental, educational and historical terms is unlikely to be fully reflected in a financial value based purely on a market price;

(b) legal and/or statutory obligations may impose prohibitions or severe restrictions on disposal by sale;

(c) they are often irreplaceable and their value may increase over time even if their physical condition deteriorates; and

(d) it may be difficult to estimate their useful lives, which in some cases could be several hundred years.

Public sector entities may have large holdings of heritage assets that have been acquired over many years and by various means, including purchase, donation, bequest and sequestration. These assets are rarely held for their ability to generate cash inflows and there may be legal or social obstacles to using them for such purposes.

Some heritage assets have service potential other than their heritage value, for example, an historic building being used for office accommodation. In these cases, they may be recognised and measured on the same basis as other items of property, plant and equipment. For other heritage assets, their service potential is limited to their heritage characteristics, for example, monuments and ruins. The existence of alternative service potential can affect the choice of measurement base.

The Committee has noted that the common characteristics of heritage assets, as referred to in IPSAS 17, were also identified in some submissions as justification for the view that cultural and heritage assets should not be recognised in the financial statements.

In Chapter 5 of this report, the Committee examines the costs and benefits of ascribing a value to cultural and heritage (particularly collection) assets. From the evidence received, it appears that some of the cultural institutions consider that the benefits obtained exceed the costs of the initial valuation. However, others do not share this view. The conclusion of the Committee is that the case for valuation is far from conclusive and there are clearly some remaining doubts as to the benefits of doing so and also the reliability of the valuations obtained.
In reviewing the reporting practices in other major countries (which are detailed in Chapter 6), the Committee noted that the valuation of collection assets is not required by the Governments in the United States, Canada and the United Kingdom. In these three countries, the approach is that a Government agency does not have to ascribe a value to its collection assets if it is satisfied that the benefits of valuation do not exceed the costs of the undertaking. Given the cost/benefit let-out, the Committee understands that very few agencies in those countries have in fact opted to value their collection assets.

The Committee is concerned to note that Australian and New Zealand are the only two countries in the world at the moment that have a mandatory requirement to value collection assets. This is at odds with the current move of the Commonwealth Government to achieve convergence of Australian accounting standards with international standards.

The Committee has been informed that the Australian Accounting Standards Board has recently commenced a project to comprehensively review the contents of AAS 27, AAS 29 and AAS 31. Therefore, it would appear to be an opportune time for the Board to re-examine the requirement to value collection assets taking into account the approaches currently adopted in other major countries and, in particular, the Commonwealth Government’s commitment to achieve greater international convergence.

2.6 Adaptation of accounting standards for the public sector

Since the early 1990s, debate has occurred about the appropriateness of the former Public Sector Accounting Standards Board’s decision to apply private sector accounting concepts to the development of public sector accounting standards. The Board considered that the private and public sectors are fundamentally similar in the information needs of the users of general purpose financial reports and, therefore, private sector accounting standards can be applied to the public sector with some modifications.
Some agencies and a number of accounting academics have challenged the Board’s approach. Their view is that parts of the public sector environment are different from the business environment and require a different approach. Moreover, the public sector environment is highly heterogeneous and should not be treated as one entity for accounting purposes.

Further, some witnesses argued that the differences in the functions and characteristics of the private and public sectors means that accounting standards need to be adapted to their environments if accounting is to be a useful financial information system. In particular, the reporting requirements for the public sector should have a special focus on stewardship, accountability and resource management.

The Committee has noted the Australian Accounting Standards Board’s recent decision to continue to issue a series of sector-neutral standards for both the private and public sectors under the International Convergence Program. In view of the above concerns, the Committee believes that it is important for the Board to be attuned to the special requirements of the public sector.

2.7 Supplementary ‘stewardship’ reporting

One of the primary functions of communicating accounting information is to provide accountability. Statement of Accounting Concepts No. 2 (SAC 2) prescribes that ‘management and governing bodies shall present general purpose financial reports in a manner which assists in discharging their accountability’ SAC 2 defines ‘accountability’ as ‘the responsibility to provide information to enable users to make informed judgements about the performance (emphasis added), financial position, financing and investing, and compliance of the reporting entity’.

In recent times, the conventional model of accountability for profit-seeking business entities (based on periodic publication of financial statements) has drawn criticism for being too narrowly focussed. It has been found wanting in discharging accountability obligations within the business sector. As a result, there have been calls for a move to ‘triple bottom line reporting’ which covers
social and environmental indicators in addition to traditional financial disclosures.

If the traditional focus on financial information is being found wanting in discharging accountability obligations within the business sector, in the Committee’s view, such an emphasis is even more problematic within the public sector domain of institutions such as museums, libraries and art galleries. It is because the objectives and raison d’être of those institutions are not solely nor even principally, of a financial character.

The change from cash to accrual accounting by Governments in all Australian jurisdictions was motivated by a need to promote better accountability within the public sector. The Committee is concerned to note that none of the three specific accounting standards on accrual accounting for the public sector (i.e. AAS 27, 29 and 31) contain a requirement for the inclusion of supplementary stewardship information to augment the data disclosed in the financial statements.

In the case of those agencies holding cultural and heritage (including collection) assets, it is widely acknowledged that the aim of their management should be to preserve and maintain the assets in good condition for the benefit of current and future generations. Some witnesses argued that the financial valuation of such assets often is not possible and is not necessarily relevant to the good management of the assets.

In the Committee’s view, the main interest of the public lies in finding out how well agencies are managing their cultural and heritage assets. The financial value of the assets is only a small part of the information needed, but it must be supplemented by extensive stewardship reporting if the agency is to properly discharge its accountability obligations.

The Committee has noted that, at present, agencies are required to include a statement in the annual report on the extent of compliance with the building and maintenance provisions of the Building Act 1993. This is a useful disclosure but the Committee is of the view that it does not go far enough.
Chapter 2: Reporting of cultural, heritage and infrastructure assets

In the Committee’s opinion, the reporting of the financial value of capital assets (including infrastructure assets) alone is not sufficient to properly account for agencies’ performance in managing those assets that have been entrusted to them. From the stakeholders’ perspective, knowing the value of the assets held by an agency as well as the cost of using the assets is important but the financial information needs to be complemented by other non-financial information if the accountability obligations are to be adequately discharged.

Therefore, the Committee believes that a similar stewardship reporting regime should be introduced on the management of infrastructure and other physical assets.

The Committee is of the view that the stewardship information (particularly the key performance indicators) should be subject to audit by the Auditor-General as to its appropriateness, relevance and accuracy. The Committee has noted that the key performance indicators reported by agencies in some of the other Australian jurisdictions (e.g. Western Australia, Tasmania and the Australian Capital Territory) are subject to audit by the Auditor-General. In the United States, the Government Accounting Office audits both the performance plans and performance reports of agencies. In the case of Canada and New Zealand, the performance information published by agencies is reviewed/audited by the Audit Office.

The proposal to subject the stewardship reporting regime to audit by the Auditor-General is aimed at:

- ensuring the integrity and reliability of the information disclosed; and
- giving momentum to achieving best practice reporting over time.

To implement the stewardship reporting regime for cultural and heritage assets, it will also be necessary to clearly prescribe the scope of its application. The Committee believes that this can be done by providing a definition for ‘cultural and heritage assets’.
Accordingly, the Committee recommends that:

**Recommendation 2.1**

(a) The following definition of ‘cultural and heritage assets’ be adopted for the purpose of the stewardship reporting regime:

‘Those non-current physical assets that the State intends to preserve because of their unique historical, cultural or environmental attributes. These assets include items such as the Royal Botanical Gardens, Herbarium, State Library, Government House, Parliament House, historic houses, monuments, certain museum exhibits, art collections, library collections, archival collections and other items of cultural significance’; and

(b) The Auditor-General determine whether part or all of the assets of an agency are within the scope of the definition and therefore should be subject to the stewardship reporting regime applicable to ‘cultural and heritage assets’.

**Recommendation 2.2**

The following stewardship information be included in the notes to the annual financial statements of those agencies that hold cultural and heritage collection assets and other cultural and heritage assets:

(a) the quantum, nature and functions of the assets and, where applicable, their cultural and heritage significance;

(b) the non-financial benefits of the assets to the community;

(c) arrangements for public access and use;

(d) restrictions on the agency’s use and disposal of the assets;
(e) the current physical condition and age (where appropriate) of the assets;
(f) the conservation and preservation policies of the agency;
(g) an estimate of the annual costs of maintenance or preservation, where applicable;
(h) the accounting policies that apply to the valuation of the assets;
(i) details of significant changes to the assets during the financial year;
(j) expenditures on new assets and donations and bequests received during the financial year;
(k) the proceeds of any sales of the assets in the financial year and how the proceeds were used; and
(l) a mix of qualitative and quantitative measures of performance in managing the assets, focusing on different operational aspects such as conservation, maintenance, acquisition, disposal and access.

Recommendation 2.3

Agencies be required to include, in a note to the annual financial statements, the following information on the management of the infrastructure and other physical assets (excluding cultural and heritage assets) under their control:

(a) the nature, functions, quantum and monetary value of each major category of assets;
(b) a brief outline of the policies adopted to manage the acquisition, operation, maintenance and disposal of the assets;
(c) an indication of the major risks associated with the operation of the
assets and how the risks are controlled;

(d) details of major assets acquired or disposed of during the financial year;

(e) total amount of maintenance expenditure incurred during the financial year as compared to the planned expenditure under the Asset Maintenance Plan;

(f) where applicable, total amount of backlog maintenance expenditure, reasons for the delay in undertaking the maintenance work as planned and projected timetable for the completion of the work;

(g) key performance indicators used to monitor and report on the operational performance of the assets together with details of actual performance against targets for the current financial year as well as the results of the previous years (i.e. trend data); and

(h) details of major initiatives implemented during the financial year to improve the operational performance of the assets.

Recommendation 2.4

The stewardship information detailed in Recommendations 2.2, 2.3 and 6.2 be subject to audit by the Auditor-General as to its appropriateness, relevance and accuracy.

Recommendation 2.5

The Department of Treasury and Finance forward a submission to the Australian Accounting Standards Board requesting a re-examination of the requirement for
public sector agencies to ascribe a value to collection assets for financial reporting purposes taking into account:

(a) the approaches currently adopted in other major countries; and
(b) the Commonwealth Government’s commitment to achieve convergence of Australian accounting standards with international standards.

Recommendation 2.6

The Australian Accounting Standards Board consult widely with constituents in the public sector when developing accounting standards so as to ensure that those standards fully meet the special requirements of the sector, particularly in relation to the issues of stewardship and accountability.

To address some of the cultural institutions’ concerns about the potential of the public misinterpreting the reported financial values of cultural and heritage collection assets, the Committee believes that a suitable explanation should be provided in the financial statements.

Accordingly, the Committee recommends that:

Recommendation 2.7

An additional note be included in the annual financial statements of cultural institutions explaining the reasons (where applicable) why:

(a) most of the cultural and heritage collection assets generally are not available for sale and, therefore, the monetary amount of those assets should not be interpreted as being available to meet financial obligations; and
(b) the changes in asset values and the related depreciation expense are not necessarily within the total control of the agency.
CHAPTER 3: ASSET VALUATION APPROACH

Key Findings:

3.1 Public sector agencies in Victoria are required to adopt current value for their cultural, heritage and infrastructure assets. At the time of the implementation of accrual accounting by Government Departments, the Department of Treasury and Finance issued a policy document on asset valuation, but this did not include guidelines as to its application in practice. As a result, many agencies had to develop their own internal policies and procedures, often with the assistance of external valuers and consultants.

3.2 Agencies generally support the adoption of the deprival value method for infrastructure assets. However, a number of concerns were raised by some agencies, including:

(a) the inconsistent approaches being applied to value certain categories of assets and to determine the ‘optimised replacement cost’ for network assets;

(b) the undue influence being exerted by some agencies on the valuers to achieve a desired outcome; and

(c) the difficulties in applying the recoverable amount test to the assets of those agencies that are subject to price control or receive community service obligation payments from the Government.

3.3 In the case of cultural and heritage assets, a significant majority of the cultural institutions have accepted the deprival value method. However, a number of institutions still challenge the appropriateness of ascribing a financial value to an asset they deem to be ‘priceless’, and maintain that cultural and heritage assets should be exempted from the valuation rules on the basis of their special characteristics. The main practical issues of concern to some of the cultural institutions are:
Key Findings (continued)

(a) the inability to obtain reliable values for certain asset categories;

(b) inconsistent approaches to determining the re-collection costs of assets that are held for exhibition; and

(c) manipulation by some institutions of the valuation amounts for prestige and funding purposes.

3.4 After several years of experience, most agencies appear to have settled on a valuation process. However, the Committee perceives a need for the Department of Treasury and Finance to provide additional practical guidance on implementation issues that agencies have identified. With the recent changeover to the ‘fair value’ method of valuation as required by accounting standards, the Australian Accounting Standards Board need to clarify the implications of the new approach. The Committee believes that, with such guidance, the change in valuation methodology could be employed to advantage in addressing any lingering concerns and inconsistencies in the application of the accounting standards.

3.5 Most agencies consider that the benefits of asset valuation have exceeded the costs. The Committee heard that agencies have used information on the value of assets and the costs of maintenance and depreciation to make decisions on:

(a) performance assessment and accountability;

(b) resource allocation and management at the agency and whole-of-government level;

(c) output pricing for the purpose of budget funding and competitive tendering; and

(d) capital investments and life-cycle asset management.
Key Findings (continued)

3.6 The Committee’s concluded view is that the valuation methods adopted in Victoria for cultural, heritage and infrastructure assets are capable of meeting the financial and operational requirements of agencies, as well as assisting in the discharge of agencies’ external reporting obligations.

3.7 Some agencies have embraced the valuation task and its underlying rationale more enthusiastically than others and the Committee believes the whole area of asset management could improve across the public sector. This could be achieved by strengthening the link between the planning, accounting and asset management systems of agencies. This linkage has assumed even greater importance given the Government’s determination to have agencies adopt best practice.

3.8 The Committee perceives considerable benefits in the Department of Treasury and Finance assuming a more active role in providing practical guidance, training and support to agencies. This should help to ensure a more consistent and efficient approach to asset valuation is applied within the Victorian public sector.

3.1 Introduction

A key aim of the Inquiry was to establish whether the asset valuation methods adopted by agencies in Victoria are appropriate for their operational and financial requirements and for external reporting purposes. Asset valuation is a major component of the Government’s accrual accounting, outputs based budgeting and corporatisation reform initiatives. To realise the benefits of the reforms, the valuation approach must be appropriate in terms of the objectives set by the Government.

In addition, the Committee examined two other related issues:

- the efficiency of the process of implementing asset valuation; and
the extent to which agencies use the accounting information generated for internal management and external accountability purposes.

3.2 Previous policies and practices

Public sector agencies in Victoria are required to adopt current value for their cultural, heritage and infrastructure assets. The State public sector assets have been valued based on the following two policy guidance documents:


Both of the above documents have now been replaced by a new policy document ‘Revaluation of Non-Current Assets’ issued by the Department of Treasury and Finance in May 2002. (See Section 3.4 of this report.)

Under the accrual accounting reform initiative, budget sector agencies were required to recognise and value all assets under their control by 30 June 1995 and all other agencies within the responsibility of Ministers were required to do so by 30 June 1996. In addition, agencies must conduct formal revaluations of assets at least every five years. Local councils are also required to adopt current value for their assets in accordance with the manner prescribed in accounting standard AASB 1041 ‘Revaluation of Non-Current Assets’.

The two policy documents which guided agencies’ valuation processes were basically high-level framework documents. They were not accompanied by any detailed practical guidelines to
assist implementation. In the absence of detailed guidance from the Department of Treasury and Finance, many agencies resorted to developing their own internal policies and procedures, often with the assistance of external valuers and consultants.

In undertaking the valuation, the deprival value method was adopted by all agencies. At the time, this particular valuation method had been widely accepted and endorsed by all Governments in Australia.

A principal catalyst for this development was the work of the Steering Committee on National Performance Monitoring of Government Trading Enterprises. The Steering Committee, established at the Special Premiers Conference in July 1991, administers a performance-monitoring regime for Government Trading Enterprises across the Commonwealth, States and Territories.

The Steering Committee’s 1994 report stated that the deprival value method provides more relevant information about both the costs of providing goods and services and the current value of resources deployed by agencies. This method is generally considered to be a major improvement on the traditional historical cost valuation approach, in terms of (a) providing relevant information for assessing the performance and financial position of public sector agencies and (b) facilitating improved asset management and pricing decisions.

An asset’s deprival value (otherwise termed ‘value to the entity’ or ‘value to the owner’) is equal to the monetary loss that an agency would incur if deprived of the service potential embodied in the asset. It can also be described as the least costly sacrifice of future economic benefits that the agency avoids, at the reporting date, as a result of controlling the asset.

Deprival value is calculated as the lower of:

- the written-down current cost of the asset; and
- the higher of net market value and value-in-use (that is, the present value of the estimated net cash inflows that the agency’s management expects to generate from the asset’s future use and subsequent disposal).
In applying the deprival value method to value assets, the key decision is whether an agency would replace the service potential embodied in the asset if deprived of that asset, taking into account existing agency objectives and Government policies. Normally, the following are the decision rules:

- if the agency would replace the asset, then it is to measure the asset’s value at the written-down current cost (that is, the lowest of the asset’s current market buying price, current replacement cost or current reproduction cost);
- if the agency would not replace the service potential of an asset, then it is to measure the value of the asset at the higher of net market value or value-in-use, irrespective of whether the asset is deployed in profit-seeking or not-for-profit activities; and
- if the asset held no longer meets the objectives of the agency and, therefore, is surplus to requirements, then the agency is to value that asset at net market value.

In the case of profit-seeking agencies (for example, public trading enterprises), the agency can be assumed to replace an asset only if the present value of the future net cash inflows to be generated from the asset’s use exceeds the replacement cost. However, non-profit seeking, budget-dependent agencies are not required to consider future cash flows because they are not relevant. As long as there is a mandate by the Government to continue using the asset to provide services, the agency should value the asset on the basis of the written-down current cost.

The Statement of Accounting Practice No. 1 (SAP 1) ‘Current Cost Accounting’ issued by the two major accounting bodies defines ‘current cost’ as the ‘lowest cost at which the gross service potential of an asset could currently be obtained in the normal course of business’. Therefore, written-down current cost is the lowest of the market buying price, current reproduction cost and current replacement cost of an asset (less related accumulated depreciation).

Under SAP 1, the replacement cost of an asset must be determined on an optimised basis, that is, the current cost of the asset must be
Chapter 3: Asset valuation approach

determined by referring to the cost of a modern equivalent asset. Current cost should not include the cost of replacing or reproducing any excess capacity, over-engineering (or over-design) or redundant components of the existing asset. Further, it should be adjusted for the relative inefficiency of the existing asset compared with the modern equivalent asset. SAP 1 requires the optimisation process to be limited to the extent that it can occur in the normal course of business using commercially available technology. The process should assume no improvement to the service potential (that is, capacity, quality of service and useful life) of the existing asset.

For example, in relation to network assets, an agency using the optimised depreciated replacement cost method would measure the cost of replacing the existing network with a new optimised network that is designed for maximum cost-effectiveness using modern materials and construction techniques. The process of optimisation measures the cost savings that could be made by adopting new network configurations and new technology, but does not measure assets at a service potential greater than that embodied within the existing assets.

In applying the deprival value method of valuation, agencies were required by the Department of Treasury and Finance’s policy document to distinguish between ‘core’ and ‘non-core’ assets. ‘Core assets’ were defined as those assets that were held because they were essential to the achievement of the agency’s objectives. More specifically, those assets were held by an agency because they were:

- necessary and able to be effectively used for the ongoing delivery of a service required by Government; or
- necessary for the distribution of goods and services to the community; or
- retained for heritage or conservation reasons.

Cultural, heritage and infrastructure assets were classified as ‘core assets’, because an agency would logically seek a replacement if deprived of them.
‘Non-core’ assets were defined as those assets that were no longer required in the pursuit of an agency’s objectives. More specially, they were assets that:

- an agency did not intend to replace if lost because the asset was not required for the long term service output of the agency; or
- an agency identified as surplus and awaiting disposal or redeployment.

‘Core’ assets were generally valued at the cost of replacing the service potential remaining in the asset. In valuing ‘core’ assets, agencies adopted the following approach for financial reporting purposes:

- assets that generated significant, separately identifiable cash flows were valued at net present value;
- where a second-hand value was obtainable, the assets were valued at the current market price; and
- all other assets were valued at written-down replacement cost.

‘Non-core’ assets were valued at their net market value except in the following special cases:

- buildings, structures, plant, equipment and furniture that were ‘non-core’ but continued to be used were valued at the higher of net market value and net present value of cash flows; or
- natural heritage assets judged to be ‘non-core’, were valued at the higher of net market value and net present value of cash flows.

### 3.3 Requirements of the accounting standards

Australian Accounting Standard AAS 29 ‘Financial Reporting by Departments’ encourages Government Departments to value infrastructure and heritage and community assets at their written-down current cost (not historical cost) using the requirements of SAP 1 as guidance. While not as detailed, AAS 27 ‘Financial Reporting by Local Governments’ and AAS 31 ‘Financial
Reporting by Governments’ have measurement requirements similar to those of AAS 29.

AAS10 ‘Recoverable Amount of Non-Current Assets’ requires the carrying amount of a non-current asset (which is valued on the cost basis) to be written down to the recoverable amount when the carrying amount is greater than the recoverable amount. The recoverable amount of an asset is defined as ‘the net amount that is expected to be recovered through the cash inflows and outflows arising from its continued use and subsequent disposal’. Excluded from the requirement to write down to the recoverable amount are those assets of not-for-profit entities that are not held primarily to generate net cash inflows, for example, Government Departments.

At the time of the introduction of accrual accounting into the Australian public sector, the accounting standard setters were cognisant of the difficulties in valuing complex public sector assets for the first time. As a result, lengthy transitional periods were included in the three standards referred to above to allow sufficient time for agencies to identify, record and value assets and set up appropriate registers and systems. The standard-setters saw their role as determining the broad principles of valuation, while the role of the agencies in the public sector was to develop efficient techniques for valuing assets with the assistance of experts.

Recent changes to AASB 1041 ‘Revaluation of Non-Current Assets’ require agencies to use the ‘fair value’ basis of measurement when revaluing their assets. Further, they must perform revaluations with sufficient regularity to ensure the monetary amount of each asset does not differ materially from its fair value at the reporting date. A driving force behind the change is the intention to harmonise Australian accounting standards with international accounting standards.

In the accounting standard, ‘fair value’ is defined as ‘the amount for which an asset would be exchanged, or a liability settled, between knowledgeable, willing parties in an arm’s length transaction’. AASB 1041 indicates the basis of calculating ‘fair value’ in three scenarios:
where a quoted market price in an active and liquid market is available for an asset, this price represents the fair value of the asset;

where no quoted market price exists for an asset but there is available market evidence for similar assets, the agency is to use the market evidence to estimate fair value; and

where the market buying and selling price differ (generally because the asset is specialised) or where no market exists for the asset, the agency is to determine fair value by referring to the replacement cost of the asset’s remaining future service potential.

AASB 1041 has included transitional provisions to provide an option to delay the full introduction of the ‘fair value’ basis, which must be completed by no later than reporting periods beginning after 30 June 2005. The aim of the provisions is to allow sufficient time for agencies to revalue their assets progressively to fair value. However, the new standard itself has already commenced operation, with the financial year ended 30 September 2001 being the first year of application.

Given that the public sector in Australia has previously used the deprival value method, the Australian Accounting Standards Board needs to clarify whether the adoption of ‘fair value’ measurement requires a revision of the present approach to asset valuation.

The Committee has been informed that the Commonwealth and State Valuers-General and the Australian Valuation and Property Standards Board have considered the application of the ‘fair value’ method of valuation. Valuation experts generally believe that fair value and deprival value should be calculated in the same way in most cases. In other words, the ‘existing use value’ and ‘depreciated replacement/reproduction cost’ concepts are the appropriate measures of ‘fair value’ for property (as they are for deprival value), while ‘market value at the highest and best use’ applies only where an agency formally decides to dispose of the asset in the near future.
While AASB 1041 does not clarify whether the reassessment of values should involve a formal process, for example, independent valuation, it acknowledges that different approaches may be adopted for different classes of assets because some assets are more susceptible to changing ‘fair values’ between reporting dates. The standard states that, for those assets that are not expected to have material variances from one reporting period to the next, the agency may index the carrying amounts to satisfy the requirements of the standard between formal revaluations/assessments.

The Committee has been informed that the Australian Accounting Standards Board has initiated a special project to consider the implications of changing from deprival value to ‘fair value’, along with related issues. Further, the Heads of Treasury have also written to the Board requesting urgent clarification on the use of the ‘fair value’ method. The Committee believes that clarification of the full implications of the change (including practical guidance on the revaluation process) is vital now that AASB 1041 has commenced operation.

Accordingly, the Committee recommends that:

**Recommendation 3.1:**

The Australian Accounting Standards Board issue practical guidance, as a matter of urgency, on the full implications of the change from the deprival value method of valuation to the ‘fair value’ method, and on other related issues such as the annual reassessment of the ‘fair value’ of assets and the relevance of the ‘highest and best use’ test in the context of public sector assets.
3.4 Government policy changes


The purpose of the new policy document is to prescribe and provide guidance on the recognition and measurement of non-current physical assets. The document reflects the new requirements of AASB 1041 and is to be applied to all agencies that are subject to the financial reporting requirements of the Financial Management Act.

Under the new policy, all classes of non-current physical assets, except for plant, equipment and vehicles (both owned and leased) must be measured at fair value. Plant, equipment and vehicles however are to be measured at cost. For the purposes of applying the policy, all assets of each agency must be categorised into the following classes:

- buildings
- cultural assets
- earthworks
- infrastructure systems
- land
- leased infrastructure systems
- leased plant, equipment and vehicles
- national parks and other ‘land only’ holdings
- plant, equipment and vehicles
- roads

The policy document provides specific guidance on a number of matters including:

- the application of the ‘fair value’ basis to different types of assets;
• the process of assessing and adjusting for material movement in ‘fair value’ between reporting periods; and
• application of the recoverable amount test.

As the guidance provided in the new policy document is at a high level, the Committee expects that some agencies will need to obtain external specialist advice and assistance in determining the ‘fair value’ of their specialised assets.

3.5 Valuation experience of agencies

To assess the appropriateness of the valuation methods and the cost-effectiveness of implementation, the Committee considered it relevant to examine agencies’ experiences in undertaking the valuation process.

3.5.1 Infrastructure assets

The experience of agencies in valuing infrastructure assets has been mixed. Most submissions and evidence given at the public hearings were concerned with the implementation process rather than the appropriateness of the valuation methods. It appears to the Committee that agencies generally do not have any conceptual difficulty with adopting the deprival value method for valuing infrastructure. However, agencies did express concerns about the following implementation issues:

• some agencies and valuers do not fully understand the intent and application of the deprival value method. Divergences in approach have subsequently emerged, making it difficult, for example, to benchmark performance across agencies and local councils;
• agencies still exhibit an unacceptable degree of subjectivity in deciding whether an asset will be replaced, because deprival value is essentially an expectations-based model;
• for those agencies which have adopted optimised replacement cost as the valuation basis, a consistent approach has not been applied in the optimisation process (e.g. inconsistent adjustments for excess capacity);
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- there are concerns about the appropriateness of applying the recoverable amount test to those agencies that operate in a controlled price-setting environment or where the community service obligation payments from the Government are inadequate; and

- the management of some agencies exerted undue influence on the valuers to achieve a desired outcome.

Some witnesses raised the different interpretations of the intent of the deprival value method as one reason for the inconsistent valuation approaches in Victoria. Mr Graeme Balfour of the Victorian Valuer-General’s Office confirmed this problem:

For a start we do not believe everyone has got a full handle on the deprival methodology just yet. It is getting there but it is not quite there.\(^{24}\)

The Knox City Council outlined to the Committee examples of assets for which agencies adopted different valuation approaches, based on different interpretations of deprival value, such as:

- ‘greenfield’ sites, for which the values are based on the cost of constructing in an open field with no obstructions and no traffic; and

- ‘in situ replacement’, for which the valuations are based on the cost to replace existing assets in their current location.\(^{25}\)

The Council also raised the issue of new technology being incorporated into asset revaluation as part of the optimisation process.\(^{26}\)

SAP 1 does not allow valuation based on optimal replacement of an agency’s entire asset network (termed ‘greenfields optimisation’). Greenfields optimisation involves determining the replacement cost of assets based on what is the most cost-effective, or optimal, set of assets to achieve the required level of service potential – in terms of capacity, service quality and useful life. It assumes the design of an entirely new optimal network asset for

\(^{24}\) Mr G Balfour, Victorian Valuer-General’s Office, transcript of evidence, p. 145

\(^{25}\) Knox City Council, submission no. 24, p. 1

\(^{26}\) Ibid
the agency. Greenfields optimisation would rarely be feasible in the public sector, given the constraints imposed by the existing network and customer access to services. For example, in the electricity distribution industry, these constraints include the given positions of supply points and customers.

The Moorabool Shire Council noted that local councils do not apply valuation methods on a consistent basis. It referred to the accounting treatment of road resealing as an example.27

The Council treats the periodic resealing costs as maintenance expense and VicRoads adopts a similar approach. However, the Auditor-General’s Office has questioned whether the reseal should be accounted for as a separate asset component of the road network and thus depreciated according to its estimated useful life.28

VicRoads also expressed concerns about local councils’ different approaches to valuing road and bridge infrastructure:29

Whilst VicRoads considers it has reliable valuation and reporting mechanisms for road and bridge infrastructure it is noted that various Municipalities have alternative approaches. A consistent approach would be desirable from a public sector reporting perspective.

The appropriateness of applying the recoverable amount test to the assets of those agencies that are subject to price control is another issue requiring resolution as identified, for example, by Melbourne Water:30

The RAT [recoverable amount test] value has key issues outstanding, which need to be resolved. RAT uses future cash inflows and outflows to derive a value. The RAT value will decline where the Government maintains a controlled price setting environment with zero price increase (since 1995) resulting in a real decline in cash inflows. Cash outflows are assumed to be maintained in real terms.

27 Moorabool Shire Council, submission no. 17, p. 2
28 Mr K. Caldwell, Accountant Moorabool Shire Council, transcript of evidence, p. 25
29 VicRoads, submission no. 25, p. 2
30 Melbourne Water, submission no. 29, p. 2
The manipulation of asset values by some agencies is another concern. Mr Jack Dunham the Victorian Valuer-General said:

*I guess those instructions are a worry in themselves because if Departmental Heads or shire CEOs can actually instruct valuers to suit themselves that is not giving us consistent valuations either. We have to have consistent instructions so we know what everyone is talking about. I guess that is one of the problems with the whole thing.*

Transitional provisions in accounting standards AAS 27, 29 and 31 permit public sector agencies to not recognise land under roads until reporting periods ending on or after 31 December 2002. Under these provisions, many public sector agencies in the State and Local Government sectors across Australia have chosen not to recognise land under roads. In the Victorian public sector, agencies have been directed by the Department of Treasury and Finance to not value land under roads.

The Australian Accounting Standards Board has not yet mandated the valuation of land under roads because there are concerns about:

- whether an entity that controls roadworks also controls the land under those roadworks;
- the reliable measurement of land under roads, including the lack of an acceptable method; and
- the possibility that the cost of measuring land under roads could exceed the benefits.

A working party has been established by the Australian Accounting Standards Board to examine the issues and to determine whether land under roads should be recognised and, if so, what practical guidance the Board should provide. The Committee understands that the Valuers-General and the Australian Valuation and Property Standards Board have been working closely with the Australian Accounting Standards Board on this matter.

The Committee has been informed that the Australian Accounting Standards Board has recently made a decision to extend the

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31 Mr J Dunham, Victorian Valuer-General, transcript of evidence, p. 152
transitional provisions in accounting standards AAS 27, 29, and 31 until there is greater international convergence on the recognition and measurement of land under roads by public sector entities. The three accounting standards will be amended to provide that entities may elect not to recognise land under roads.

The Committee is pleased to note the decision of the Australian Accounting Standards Board. It clearly recognises the importance of aligning the Australian approach in public sector accounting with the frameworks adopted by other major countries as part of the world-wide convergence developments. As indicated earlier in this report, the Committee is concerned that this is not the case particularly in relation to the valuation of cultural and heritage collection assets.

### 3.5.2 Cultural and heritage assets

Regarding cultural and heritage assets, the major concerns expressed by some of the cultural institutions centred on:

- the excessive cost of asset valuation relative to the benefits obtained;
- the inability to obtain reliable values for certain categories of assets;
- inconsistent approaches to determining the re-collection costs of those assets that are held for exhibition;
- some institutions’ manipulation of the valuation amounts for prestige and funding purposes; and
- the requirement to adopt the written-down current cost approach, involving depreciation, for cultural and heritage assets even though the assets do not deteriorate in any material sense but often increase in value over time.

AAS 29 ‘Financial Reporting by Government Departments’, required agencies to have their cultural and heritage assets valued by 30 June 1999. Cultural and heritage assets are those assets that are held by agencies because they have unique cultural, historical, geographic, scientific and/or environmental attributes. They help the relevant agencies to meet exhibition, education, research and
preservation objectives, all of which are directed at providing a cultural service to the community.

Some cultural and heritage assets are solely of a historical or cultural interest (for example, museum and library collections) while others also provide a functional service (for example, heritage buildings used as commercial offices).

Under the former policy of the Department of Treasury and Finance, the valuation of cultural and heritage assets was required to be based on the deprival value method. The policy did not mean that those assets necessarily had to be valued using market selling prices or market buying prices (that is, the so-called commercial values, as referred to by some critics of the valuation process). Market prices would only be required to be used in a minority of cases.

In general, the cultural and heritage assets of the Victorian public sector fall into one of three categories:

- those assets for which a relevant market exists and therefore a current market buying price can be obtained;
- those assets for which no relevant market exists but the cost to reproduce the asset in its present form or replace the asset with an equivalent item (serving a similar purpose) can be estimated; and
- those that cannot be reliably valued because they are unique and thus replacement with an identical or equivalent asset would not be possible, either by reference to a market or by means of re-collection.

The above three bases were adopted by the cultural institutions when they undertook the initial valuation. Most cultural and heritage assets fall into the first two categories. However, in certain cases, valuers generally accept that it may be difficult to reliably value assets. Support from an external expert is normally expected where an agency decides not to recognise certain assets because they are unable to obtain a reliable value.

The experience of cultural institutions shows that reliable measurement may be difficult for certain types of asset, including:
• unique items that have iconic status (for example, a landing board used at Gallipoli and an original Eureka flag);
• certain historic library and museum collections; and
• items that are sacred to particular communities.

Set out below is an outline of the asset valuation approach commonly adopted by Victorian cultural institutions.

Normally, institutions undertake the valuation projects in cooperation with the collection managers, curatorial staff, valuers, statisticians and finance officers. Identification and assessment is the first step in establishing a collection item’s contribution to the objectives of the agency and whether it can be valued reliably. This process may produce an opinion that certain items no longer contribute to the objectives of the agency. If the agency is to dispose of these assets, it adopts the market selling price as the value. Acquisition and de-accessioning policies often provide guidance on the intended purposes and use of the collection assets.

To obtain a valuation that is materially accurate but at a reasonable cost, institutions have adopted different sampling methods. They value identified ‘high-value’ items and subject the remainder of the collection assets to a sampling method. Threshold values are developed for this purpose; assets above the thresholds are valued individually, while assets below the thresholds are sampled on a random or other basis for valuation.

The Committee was informed that some cultural institutions adopt a minimalist approach in selecting samples for valuation, while others undertake comprehensive sampling, resulting in excessive costs for the valuation exercises.

Some library/museum collection items and works of art can usually be valued reliably based on market selling value because the markets are sufficiently deep and expert valuers are available. However, most other collections normally have very thin markets. Given the specialised nature of these other types of asset, the general approach is to determine the cost of buying another asset serving a similar purpose (replacement cost) or the cost of
reproducing the asset in its present form or in another form that serves a similar function. The current cost chosen is the lower of the replacement cost and the reproduction cost of the asset.

For specimens, the cost of mounting an expedition or field trip to collect similar replacement specimens, together with the cost of their documentation and preparation, represent their reproduction cost. In determining the replacement or reproduction cost of an asset, agencies using the deprival value method must consider the function/purpose of the asset. It may be possible to replace the function of an asset not with an identical asset but with another type of asset. Therefore, the absence of an active secondary market for a particular type of asset does not necessarily mean that it cannot be measured reliably.

An asset may represent a certain school of art, the clothes of a particular historical person or an example of pre-war film production. It is possible to replace the function that such a unique item performs by acquiring another painting of that school, some other possessions of the historical character or a copy of another film of that period.

However, if a collection asset is held because it is a painting by a particular artist, or the clothes worn by a famous fashion model or the work of a particular film producer, then the valuers generally accept that the replacement items used for valuation must relate to those specific persons.

The experience of the institutions is that the value of certain collection assets cannot be reliably measured because their function cannot be replaced.

Heritage buildings normally have few or no alternative uses, so the land content is valued according to its ‘existing use’ and the building structures are valued using replacement cost. The buildings generally have both functional as well as heritage characteristics. The value of the heritage or aesthetic utility component may be difficult to reliably measure because market evidence for this component generally is not available. In these instances, the heritage components are not valued for financial reporting.
However, Victoria has some cases where heritage buildings may be available for a feasible alternative use. For example, a police station situated in a heritage building could be relocated so the building can be used for residential purposes. Where an alternative use is feasible within the existing socio-political environment, the property is valued at market selling price based on highest and best use, which may be, for example, as a residential building.

In determining the current replacement cost for functional heritage buildings, the valuer assumes that the existing buildings will not be rebuilt but will be replaced by modern equivalent buildings with similar service potential.

Some cultural institutions considered that the cultural and heritage features of the collection assets must be valued:

> It is emphasised that every specimen in the State Botanical Collection possesses unmeasurable cultural, heritage and scientific values. ... It is impossible to put a reliable market value on a specimen of a species now extinct.\(^32\)

The Committee acknowledges that the Department of Treasury and Finance’s former policy did not require valuation of the cultural and heritage features of an asset if that valuation would not be reliable. The aim of the deprival value method is to determine the cost of obtaining a replacement asset that services a similar purpose, and it follows that this can only be done where a replacement is available.

Mr Martin Hallettt of Museum Victoria highlighted another issue to be addressed by the valuation profession. Valuers still do not agree whether the replacement cost of a collection asset should include, in addition to the re-collection costs, the costs of preparing the item for storage and exhibition as well as the costs of documenting the item in the databases:

> It is a valid point that if we were deprived of the item we would have to re-document its replacement and the deprival value should include that. The discussions we originally had with the Valuer-General and Treasury led us to the conclusion to

\(^{32}\) Royal Botanic Gardens of Victoria, submission no. 13, p. 4
exclude those preparation and documentation costs from the re-collecting costs. Maybe we need to revisit that.33

Mr Graeme Addicott of the Australian Valuation Office (Darwin Region) raised a concern that a few cultural institutions across Australia are tempted to influence the valuation process, mainly for prestige and funding reasons:

Both prestige and funding put some kind of imperative on the managers to attempt to influence the value by inflating or inappropriately valuing the material in those collections.34

Some cultural institutions expressed reservations about the appropriateness of valuing cultural and heritage assets based on the written-down current cost approach. This approach involves determining the gross replacement cost of an asset in the first instance and then write down the value to account for the service potential that has been consumed. The resultant amount reflects the ‘fair value’ of the asset. In response to this concern, Mr Frank Micallef made the following suggestion:

The standards do force you, in the public sector at the moment, into this gross current cost and then depreciation approach, which is probably fine for a lot of infrastructure-type assets but not for a lot of heritage assets. If you have a market value for something, the market value is the market value. It does not make a lot of sense to go out there and try to determine its gross current cost and then depreciate it. It seems to me we have another group of assets that probably should be exempted from the strict, cost and depreciation-type requirements.35

The Committee was advised that the major accounting standard-setting bodies around the world have not yet made a decision on whether the ‘exit-value’ (i.e. market selling value) accounting model is appropriate for cultural and heritage assets as there are many difficult conceptual issues involved.

After a number of years of experience, most agencies appear to have settled on a valuation process. However, the Inquiry has identified practical issues that still need to be resolved.

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33 Mr M Hallett, Museum Victoria, transcript of evidence, p. 34
34 Mr G. Addicott, submission no. 44, p. 34
35 Mr F Micallef, transcript of evidence, p. 82
Accordingly, the Committee recommends that:

**Recommendation 3.2:**

The Department of Treasury and Finance issue practical guidance to agencies on:

(a) the intent and objectives of the prescribed valuation methods;

(b) the application of the optimisation process to determine the optimised depreciated replacement cost for infrastructure assets;

(c) the valuation of road and bridge infrastructure;

(d) the appropriate accounting treatment for determining items to be capitalised or charged as maintenance (for example, periodic resealing of roads);

(e) the application of the recoverable amount test to those commercial agencies that are subject to price control or receive community service obligation payments from the Government;

(f) the valuation approach to be adopted for those cultural or heritage assets that are difficult to value in a reliable manner;

(g) the application of sampling methods to asset valuation (including the valuation of collection assets); and

(h) the determination of the replacement cost for collection assets, including whether the preparation and documentation costs should be added to the re-collection costs.
3.6 Benefits of asset valuation

Statement of Accounting Concepts (SAC) No. 2 ‘Objective of General Purpose Financial Reporting’ states that general purpose financial reports are prepared to provide users with information about the reporting entity which:

- is useful for making and evaluating decisions about the allocation of scarce resources;
- assists management and governing bodies in discharging their accountability; and
- is relevant to the assessment of performance, financial position, financing, investing and compliance.

Also, for financial information to be useful, SAC 3 ‘Qualitative Characteristics of Financial Information’ states that the information must meet the criteria of relevance, reliability, materiality, timeliness, comparability and understandability. According to the accounting standard-setters, the objective of valuing physical non-current assets is to report on the value of the economic benefits or service potential embodied in the assets so as to provide relevant and reliable information for decision-making about resource allocation, asset management, performance assessment and accountability.

The Victorian public sector undertook asset valuation while implementing the accrual accounting reform in the 1990s. This particular reform initiative was designed to enhance accountability for all resources controlled by agencies, and was expected to lead to greater efficiency in managing resources. One of the purposes of accrual financial statements is to provide users with comprehensive information about the community’s ‘investment’ in the capability of agencies to deliver services that meet the needs of the stakeholders.

Mr Greg Pound of the Victorian Auditor-General’s Office expressed a similar view:

*Therefore, we believe accrual accounting is essential for quality financial reporting and quality financial reporting is essential for making and evaluating decisions about the allocation of scarce resources, whether it be from an internal management*
perspective or from an external accountability perspective. In that context the valuation and reporting of heritage and infrastructure assets is a significant component of providing complete and relevant information for effective decision-making by a range of stakeholders.\(^{36}\)

However, he also pointed out that the benefit of valuation may be difficult to quantify:

> As I said earlier, the costs of implementing any recognition and valuation of assets can be quite easily identified, but the benefits are intangible and much more difficult to measure.\(^{37}\)

Apart from the Victorian Auditor-General’s Office, the Australian Accounting Standards Board, the Department of Treasury and Finance and most other agencies also indicated to the Committee that they believe the benefits of valuation have exceeded the costs, although they acknowledged that the benefits are difficult to quantify. The benefits mainly relate to improvements in the quality of the information produced by the accounting systems for decision-making and accountability.\(^{38}\)

However, some agencies were not convinced about the benefits of asset valuation relative to the costs incurred. For example, Mr Doug Thompson, Director of Finance at VicRoads, made the following comments:

> The most important part of our asset register is that we know what we have got. We know every bridge, all the culverts and all the roads and we know every section of the roads and what condition they are in, so we can manage that asset. Putting it in the books may make you feel warm and cosy, but does not do anything for the public of Victoria, and I question the spending of hundreds and hundreds of thousands on it.\(^{39}\)

Chapter 5 contains a detailed analysis of cultural institutions’ views on the benefits of asset valuation to the internal management of those organisations and to external accountability.

\(^{36}\) Mr G Pound, transcript of evidence, Victorian Auditor-General’s Office, p. 15
\(^{37}\) Ibid
\(^{38}\) Mr K Caldwell, Moorabool Shire Council, transcript of evidence, p. 131
\(^{39}\) Mr D Thompson, VicRoads, transcript of evidence, p. 44
The Committee was informed that the Australian Accounting Standards Board is required by its charter to consider costs and benefits when developing accounting standards, as was the case with the former Public Sector Accounting Standards Board. The Board’s issue of any new accounting standard is subject to the provision of a Regulatory Impact Statement.

The accrual accounting reform in Victoria was followed by the adoption of a new budgeting model based on outputs to be delivered by agencies as agreed with the responsible Ministers. Funding provided to agencies is based on the agreed prices for the outputs. The prices are calculated to reflect the full cost of delivering the outputs, including depreciation and maintenance expenses, as well as a charge for the capital used in the operations.

It is acknowledged that information on the value of assets and the costs of maintenance and depreciation is important for making decisions on:

- performance assessment and accountability;
- resource allocation and management at the agency and whole-of-government level;
- output pricing for the purpose of budget funding and competitive tendering; and
- capital investments and life-cycle asset management.

Data on assets, depreciation and maintenance are required to produce a large number of the financial performance indicators used to monitor the performance of Government business enterprises. Apart from performance monitoring at the individual agency level, a national performance monitoring regime also applies to Government business enterprises in the various jurisdictions. The regime was established at the July 1991 Special Premiers Conference and is oversighted by a steering Committee. Under the regime, a series of financial and non-financial indicators covering all the participating Government business enterprises are published periodically, to allow an individual jurisdiction to benchmark its performance against that of the other jurisdictions.
In the case of Government business enterprises, asset valuation (and the related depreciation policy) also has major effects on the enterprises’ revenue requirements and pricing policies, because those agencies generally have extensive capital infrastructure. Public business enterprises are required by Government to recover the full cost of services, including a return on their assets. Therefore, accurate information on asset values and depreciation is important, because whenever assets are revalued, this must ultimately impact on costs and prices.

Many public business enterprises have significant market power. Given the absence of market disciplines, various forms of regulatory control have been implemented to ensure monopoly rents or excessive profits are not extracted from these markets. Some jurisdictions have adopted the overseas model of independent price regulators. Victoria’s regulatory body is the Essential Services Commission. In the price-setting process normally, accounting information is adjusted and then used as the baseline.

The Committee observed that the implementation of National Competition Policy also has major implications for public business enterprises. One issue is access pricing for the use of infrastructure such as railways and ports. Again, in these cases, asset valuation and rate of return are critical issues for an enterprise’s revenue determination and pricing.

The significance of asset valuation for price/revenue setting is evident, for example, in the recommendations of the National Grid Management Council (1994) and the Expert Group on Water (1995). In both cases, the deprival value method was recommended for the asset valuation, which underpins the determination of network company revenue requirements and the definition of asset-related cost in the provision of water services.

Based on the evidence examined, the Committee has concluded that the valuation methods adopted in Victoria for cultural, heritage and infrastructure assets are such that they are capable of producing information that meets the financial and operational requirements of agencies. Further, those valuation methods are also appropriate for use in preparing financial reports to the external stakeholders.
3.7 Integrated asset management

Effective and accountable asset management is central to the sound financial management of Victoria’s resources. Quality asset and infrastructure management is also essential to the promotion of economic growth across the whole State. The ultimate aim of asset management is to optimise the useful life, capability and utilisation of assets thus leading to better service delivery.

The Asset Management Series (issued in 1995) sets out the Victorian public sector’s policy framework for asset management. The series forms part of the Directions of the Minister for Finance issued under the Financial Management Act 1994. It is supported by the Government’s asset management policy statement ‘Sustaining Our Assets’ (December 2000). This statement sets out:

- the objectives of, and principles for, optimal asset management;
- the integrated asset management approach;
- an overview of asset management responsibilities; and
- asset performance management expectations.

In addition, the Department of Infrastructure has produced a manual that is designed to help all Departments to implement sound asset management procedures in line with Victorian Government policy. The manual sets out generic asset management procedures as practical guidance to Departments.

The Department of Treasury and Finance indicated that it will soon issue a new policy document on asset management. The document will include a communication strategy and a communications plan.

The communications strategy will outline the direction to be taken to improve asset management in Victorian Government departments. Specifically, it will address the move to the best practice position.

The communications plan will contain detailed actions to promote increased awareness and understanding of strategic asset management and to deliver the direction given in the strategy.
As part of the communications strategy, the Department will release a comprehensive asset management guidance package comprising a revised Asset Management Series, together with additional supporting material. The new series will include the ‘Sustaining Our Assets’ policy statement, an asset investment allocation model, principles and strategies, and policies and practices. The Department of Treasury and Finance will use the asset investment allocation model to assist the government in achieving more strategic asset management and improved capability in resource allocation.

The Committee examined whether the accounting information generated by agencies on asset values, depreciation and maintenance has been effectively used across the public sector for asset management. This issue assumes even greater importance given the Government’s focus on moving agencies to the best practice position. The Committee’s conclusion is that asset management could improve across the public sector, although some agencies have performed better than others. Further, accounting information needs to be better linked to the asset resource allocation model at both the whole-of-government and agency levels.

Many agencies identified the inadequacy of integration between the accounting systems and the asset management systems as a concern. Mr Graeme Balfour of the Victorian Valuer-General’s Office made the following point:

*We believe there could be some more work done in regard to that, to come up with some better ways of actually turning the valuations into a management tool to better maintain the assets.*

It is the Committee’s view that agencies should be held directly accountable for the management of the resources under their control. Therefore, it is their responsibility to ensure that adequate resources and priority are given to this particular area and their performance in managing those assets is assessed by the internal accountability process (for example, Audit Committees).

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40 Mr G Balfour, Victorian Valuer-General’s Office, transcript of evidence, p. 147
Accordingly, the Committee recommends that:

**Recommendation 3.3:** Agencies dedicate adequate resources and priority to improving the management of assets on a whole-of-life basis and to better integrating the asset management systems with the corporate and business plans and also the accounting systems.

**Recommendation 3.4:** A particular agency within the Victorian public service, for example, the Department of Infrastructure, be given responsibility to provide ongoing practical advice and assistance to other agencies on asset management issues, subject to the oversight of the Department of Treasury and Finance.

### 3.8 Audit Report on Road Management by Local Government

In June 2002, the Auditor-General of Victoria tabled in Parliament a report on Management of Roads by Local Government. The main objective of the audit was to assess whether the road infrastructure asset management practices adopted by local councils have economically, efficiently and effectively optimised the useful life and capability of those assets. Issues examined by the audit included:

- the condition of existing road infrastructure;
- the adequacy of processes to maintain assets and of public accountability practices of councils; and
- whether the State Government has facilitated and encouraged best asset management practices by local government.

Nine of the State’s 78 councils were selected for an examination of their asset management practices. The audit also examined the
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Department of Infrastructure’s support for councils in this area and the funding model of the Victoria Grants Commission.

The major conclusions of the audit are summarised below:

- local Government (councils) has been managing road infrastructure assets, including bridges, drains and footpaths for several decades. In recent years, studies undertaken across the Local Government sector have identified asset management problems that needed to be addressed;

- the audit focussed on an assessment of current asset management practices and found that there had been some success, albeit from a low base. The audit noted councils were eager to learn more about best practice and displayed a genuine desire to improve;

- at the present time, the practices of the sector as a whole have not yet reached a level that meets accepted best appropriate practice or properly meets the long term needs of the community. Moreover, the sector is unable to determine with any degree of certainty (and nor was audit) the overall condition of road assets or whether they will reach their optimum useful lives. This has serious funding implications in that councils and the Victoria Grants Commission cannot be certain annual allocations are sufficient to maintain assets or provide for their eventual replacement over the long-term;

- in contrast, councils in New South Wales, Western Australia and New Zealand have been provided with a standardised condition assessment model and are required to report annually on the condition of their roads. This information assists councils to determine their capital and maintenance expenditure requirements. It is also used by funding agencies to assess funding requests and determine allocations. This approach facilitates accurate reporting on the total road network and its condition. The Auditor-General is of the view that while action is in train to improve Victorian asset management practices, the attention given to improving asset management practices by the Department of
Infrastructure and councils is not being given sufficient priority; and

- the Auditor-General believes that the Department of Infrastructure could be more pro-active in providing training and support. This would be assisted by canvassing a broad range of councils to identify their specific needs and by analysing council performance data to pinpoint areas of weakness. Although councils are eager to learn more about best practice and keen to improve, more effort is required to improve their practices and raise the profile of asset management. Councils also need to provide the community with better information on their performance in managing road infrastructure assets.

The Committee believes that the Auditor-General’s report is timely as the findings and conclusions about the state of road management in Local Government, in many ways, also reflect the concerns that the Committee has regarding asset management across the Victorian public sector. A number of recommendations have been made in this report to address those general concerns (see Recommendations 2.1-2.4, 3.3-3.4 and 6.2).

3.9 Asset valuation implementation strategy

In the past, apart from the occasional issue of bulletins and other related documents, the Department of Treasury and Finance has provided only limited practical guidance to agencies on asset valuation.

As a result, many agencies have resorted to using external consultants and valuers, adding to the overall cost of asset valuation. Agency experience reveals that a large number of issues encountered in asset valuation are common to many agencies. However, there are no formal mechanisms to facilitate:

- the resolution of general issues that are not agency specific; and
- the exchange of knowledge, experience and information among agencies.
Therefore, the Committee perceives considerable benefits from the Department of Treasury and Finance assuming a more active role in providing practical guidance, training and support to agencies. This should help to ensure a more consistent and efficient approach to valuation is applied across the public sector. Further, substantial cost savings are expected from a whole-of-government perspective.

In particular, the Committee considers that the Department of Treasury and Finance should adopt an implementation strategy with the following elements:

- the development of an asset valuation manual, setting out the broad policy framework and detailed practical guidance on the common issues that agencies face in valuing assets and accounting for depreciation and maintenance. The manual should be a ‘living’ document, i.e. regularly updated with input from agencies and valuers;
- the provision of training and education, including workshops, seminars and discussion forums;
- the establishment of liaison and support networks to facilitate the exchange of knowledge, experience and information among agencies; and
- the creation of a special website at the Department of Treasury and Finance to enable the sharing of information across the public sector and to support issues and knowledge management.

The Committee believes that all agencies need to work together and that the Department of Treasury and Finance needs to assume a leadership and coordinating role. Both the Valuer-General’s Office and the Auditor-General’s Office should be consulted in the development of the asset valuation manual and in resolving general issues.

Accordingly, the Committee recommends that:

**Recommendation 3.5:**

The Department of Treasury and Finance develop an Asset Valuation
Implementation Strategy to provide practical guidance, training and support to agencies, as well as facilitating the sharing of information and experience across the public sector.
CHAPTER 4: DEPRECIATION OF CULTURAL, HERITAGE AND INFRASTRUCTURE ASSETS

Key Findings:

4.1 Generally, agencies have found the depreciation methods prescribed in the accounting standards to be suitable for performance assessment, asset management and pricing/funding decisions within the Victorian public sector.

4.2 Some agencies still have concerns about the practical application of the depreciation methods. Examples of concerns are: the difficulty of establishing accurate useful lives for long-lived assets; the potential for manipulation of depreciation and maintenance charges; and inconsistent approaches to depreciating similar assets.

4.3 The Australian Accounting Standards Board recently provided guidance on specific issues raised by the public sector relating to depreciation and maintenance.

4.4 To help agencies resolve implementation issues, the Committee considers that the Department of Treasury and Finance needs to provide further detailed practical guidance. In addition, appropriate arrangements need to be set up to facilitate the exchange of knowledge, experience and information among agencies, as well as the benchmarking of depreciation practices within specific industries.

4.5 Asset management could be improved across the Victorian public sector. The sophistication of the asset management systems established by agencies varies greatly.
4.1 Introduction

A major issue examined by the Committee was whether the depreciation methods outlined in the Australian Accounting Standards are compatible with, or appropriate for cultural, heritage and infrastructure assets owned by the Victorian Government (term of reference No. 3). The depreciation methods adopted have certainly had a major impact on the depreciation expense recorded by an agency. The expense flows through to the reported operating results of the agency, and has implications for the pricing of products and services and asset management. Therefore, the depreciation approach in the public sector is important not only for performance assessment, but also for pricing and funding decisions. For the year ended 30 June 2001, the total depreciation expense for the State public sector was $1,316 million as compared to the net operating result in respect of that year of $1,003 million.\footnote{Department of Treasury and Finance, 2000-01 Financial Report for the State of Victoria, p. 49}

Another issue examined by the Committee was whether the current depreciation methods prescribed by accounting standards are suitable for the effective management of the diverse range of assets held by agencies.

The Committee is also aware that depreciation treatment, under the existing outputs-based funding model, can have a redistribution effect on the allocation of funding among competing Government outputs. Therefore, there are intra-generational equity issues involved given that funds may be transferred from one output group to another.

To the extent that depreciation has an influence on the reported budget position for the State, any Government policy decisions on budget strategies (for example, changing taxes and/or Government expenditures) would also have an impact on future generations. The Committee is concerned that the Government does not overlook the possibilities for intergenerational wealth transfers as a result of accounting rules being applied.
From the submissions received and the evidence given at public hearings, the Committee identified the following concerns of agencies:

- inconsistency and arbitrariness in the current approach to depreciation;
- instances of manipulation of depreciation expenses to achieve a desired outcome in financial reporting, budget allocation and competitive tendering;
- difficulties in establishing accurate useful lives for long-lived cultural, heritage and infrastructure assets;
- the requirement to record depreciation for cultural and heritage assets that have an indefinite useful life;
- the need to record depreciation for certain cultural and heritage assets even though the values of those assets have increased;
- the prohibition of ‘condition-based depreciation’; and
- confusion as to the distinctive roles of depreciation and maintenance in accounting and asset management and the potential for a ‘double dip’ effect in financial reporting and budget allocation.

4.2 Accounting standards requirements

Assets with limited useful lives are required to be depreciated in accordance with AAS 4 ‘Depreciation’. The AAS 4 approach to depreciation is to allocate the cost (or other revalued amount substituted for cost) of an asset to different reporting periods during the asset’s useful life. More specifically, it systematically allocates the acquisition cost of a non-current asset (or revalued amount) as an expense to each of the reporting periods over which the asset is used.

The objective of the accounting allocation process is to provide an appropriate measure of the costs of using the assets in generating revenues or other outputs for particular reporting periods. Depreciation can be a major cost component for those agencies that have large and extensive infrastructure assets.
The method chosen must reflect the pattern in which the agency uses or loses the service potential of an asset. Most assets (including infrastructure assets) have limited useful lives; that is, the service potential of such assets declines over time and through use until it is consumed or lost. The decline in service potential can be due to a number of factors, including physical wear and tear, technical obsolescence or commercial obsolescence.

AAS 4 requires the cost of a depreciable asset to be allocated on a systematic basis over the asset’s estimated useful life. The depreciation methods commonly used to allocate this cost are formula based. The straight-line method is most often used. Under this method, the depreciable amount (that is, the cost or revalued amount minus the estimated residual value at the end of the asset’s useful life, where applicable) is allocated in equal proportions to each reporting period. The accounting standard requires agencies to reassess at least annually the assets’ useful lives and the depreciation methods and rates used.

The submissions and the evidence given at public hearings suggest that some agencies still do not understand the distinctive roles of depreciation and maintenance in both the accounting and asset management contexts. For the year ended 30 June 2001, the total maintenance expense for the State Public Sector was $529 million.42

One academic pointed out that a ‘double dip’ effect could result if an agency includes both depreciation and maintenance expenses in its Statement of Financial Performance.43 Ms Carmel Capitanio advocated capitalising all repair and maintenance costs, that is, adding to the asset’s recorded value, to eliminate the ‘double dip’ effect:

...charging depreciation through the operating statement causes a ‘double dip’ effect – costs of repairs and maintenance as well as depreciation, determined on a current cost basis, may be charged to the operating statement thus reducing the operating result to a level below that which reflects actual occurrences. Repairs and maintenance costs need to be capitalised (added to the asset’s recorded value) to eliminate the

42 Ibid, p. 84
43 Ms C. Capitanio, Lecturer La Trobe University, submission no. 10, p. 18
‘double dip’ effect. Clearly, the validity of charging depreciation to the operating statement as well as repairs and maintenance costs needs to be further considered.44

For the determination of an asset’s estimated useful life against which to calculate depreciation, the accounting standard clearly requires an agency to assume the level of ongoing and major periodic maintenance needed over time to achieve the pre-determined useful life. Depreciation and maintenance expenses, therefore, are two distinct components of the total cost of using an asset in the agency’s delivery of service.

If the originally assessed level of maintenance cannot be completed because there are budgetary constraints, for example, then the useful life normally needs to be shortened to reflect that the maintenance program has not dealt with the physical wear and tear as planned. On the other hand, if the maintenance conducted is higher than the level originally assumed, then there may be a case to extend the pre-determined useful life of the asset.

Thus there is a direct relationship between depreciation and maintenance. A shortening of the asset’s estimated useful life means the depreciation expense for each future reporting period will be larger than it otherwise would be. This reflects a greater loss of the asset’s service potential, through wear and tear, than originally anticipated, as a result of the maintenance shortfall. However, an extension of the useful life has the opposite effect on future depreciation expenses.

Normally, if the maintenance expense is reduced because a lower level of maintenance is undertaken (compared with the original plan), then there should be a corresponding increase (although not necessarily of the same amount) in the depreciation expense as a result of the shortening of the useful life. However, if the maintenance expense increases, then there should be a corresponding reduction in the depreciation expense as a result of an extension of the useful life.

Major components of some infrastructure assets may require replacement at regular intervals. Examples are electricity, water and transport network assets, major items of plant and equipment, 44 Ibid
and buildings used within the public sector. Agencies usually plan and manage major overhaul, refurbishment or refit as part of an ongoing, comprehensive cyclical maintenance program. The accounting standards require agencies to account for the major components as separate assets and thus depreciate them separately, because those components may have useful lives quite different from those of the infrastructure assets to which they relate.

The existing accounting standards provide clear rules on how to account for repair and maintenance costs in the financial statements. These rules do not allow all repair and maintenance expenditures to be capitalised, as advocated by Ms Capitanio. The Australian accounting approach is consistent with that adopted by other major countries around the world.

AAS 4 makes it clear that any expenditure on an existing asset can only be recognised as part of that asset (and therefore included in the total cost for that asset) when that expenditure extends the asset’s estimated useful life or improves the condition of the asset beyond the originally assessed standard of performance or capacity. Examples of improvements that result in increased service potential include:

- the modification of an item of plant to extend its useful life, including an increase in its capacity;
- the upgrading of infrastructure parts to achieve an improvement in the quality of output; and
- the adoption of new production processes, enabling a reduction in previous operating costs.

The costs of repairs and maintenance that do not extend an asset’s useful life or improve the condition of an asset are required to be treated as an expense for the period in which the costs are incurred. Those repairs and maintenance are necessary merely to realise the service potential expected from the asset; for example, the cost of rectifying a plant breakdown is treated as an expense. Similarly, the costs of routine maintenance and periodic maintenance which merely ensure an asset reaches its estimated useful life are also an expense.
4.3 Department of Treasury and Finance policy

The depreciation policy of the State is explained briefly in the statement of significant accounting policies included in the 2000-01 Financial Report for the State of Victoria.\(^{45}\)

Under the policy, all infrastructure, buildings, plant and equipment and other non-current assets that have a limited useful life must be depreciated. Depreciation is generally calculated on a straight-line basis at rates that allocate the asset’s value, less any residual value, over its estimated useful life to the controlling entity. Depreciation rates and methods are required to be reviewed annually. The following are typical estimated useful lives for the different asset classes:

<table>
<thead>
<tr>
<th>Asset class</th>
<th>Useful life</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dwellings</td>
<td>40 to 50 years</td>
</tr>
<tr>
<td>Other buildings</td>
<td>30 to 60 years</td>
</tr>
<tr>
<td>Other infrastructure</td>
<td>10 to 32 years</td>
</tr>
<tr>
<td>Road pavement</td>
<td>60 years</td>
</tr>
<tr>
<td>Bridges</td>
<td>90 years</td>
</tr>
<tr>
<td>Plant and equipment</td>
<td>3 to 10 years</td>
</tr>
<tr>
<td>Heritage assets</td>
<td>100 years</td>
</tr>
<tr>
<td>Water infrastructure – storage facilities</td>
<td>25 to 300 years</td>
</tr>
<tr>
<td>Water infrastructure – other</td>
<td>25 to 100 years</td>
</tr>
</tbody>
</table>

Note:
Land and earthworks associated with the declared road network and core cultural assets, which are considered to have indefinite life, are not depreciated. Depreciation is not recognised in respect of these assets as their service potential has not, in any material sense, been consumed during the reporting period.

The key points of the State’s depreciation policy for all assets are that:

- the straight-line method of depreciation is generally used; and
- the useful lives of the assets range from 3 to 300 years.

A number of the cultural institutions indicated to the Committee that they have experienced difficulties, caused by asset longevity, in determining appropriate depreciation rates for certain items of

\(^{45}\) Department of Treasury and Finance, 2001-02 Financial Report for the State of Victoria, p. 60
collection assets. Some of the institutions also indicated concern about the policy stipulation that heritage assets have a useful life of a maximum of 100 years.

The National Gallery of Victoria’s submission indicated the general concerns of some cultural institutions:

The individual works themselves do deteriorate and many thousands of dollars are expended on preserving and conserving the works to maximise their useful life. But the issue of depreciation becomes problematic due to the longevity of many works, thus making an appropriate depreciation rate difficult to establish.

A useful life of 100 years (annual depreciation rate of 1 per cent) appears reasonable at first glance. However, on reflection it seems totally inappropriate given that many works (especially non-Australian works) are three, four and five hundred years old.

Although the policy includes a schedule of typical estimated useful lives for different asset classes, the Committee understands that they are intended only as a guide and that each agency is responsible, in consultation with the Auditor-General’s Office, for determining the actual useful lives of its own assets.

Two further important points can be noted from the policy. First, if the amount of depreciation expense is not material because the assets of a particular agency have extremely long useful lives, then the expense item need not be recorded in the financial statements. AAS 29 gives an illustrative example (in the appendix) of a situation regarding heritage assets, where the agency recorded no depreciation of the assets because they ‘have very long and indeterminate useful lives’ and ‘their service potential has not in any material sense been consumed during the reporting period’.

Second, the policy states that an underlying principle of heritage classification is that the asset will be retained in perpetuity and maintained accordingly. It explains that the ‘one hundred year’ useful life is chosen only as a practical approximation of an asset being retained in perpetuity. In other words, agencies do not have to follow the ‘one hundred year’ guide if it is not appropriate.

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46 National Gallery of Victoria, submission no. 28, p. 3
4.4 Appropriateness of existing depreciation methods

Under existing accounting standards, depreciation can help to identify the current cost of using the assets held by public sector agencies. Agencies can then combine asset costs (which include maintenance expense) with other costs to determine the full cost of providing a service. This is important for pricing outputs that are delivered by budget sector agencies, as well as for other pricing decisions made by Government businesses. Errors in estimating depreciation expenses would lead to inaccurate information about the cost of providing goods and services, as well as to misleading asset values.

Each agency must have a policy to review the depreciation rates at least annually and make adjustments, if necessary, so the rates reflect the most recent assessments of assets’ useful lives. For example, subsequent expenditures on an asset that improve its condition may extend the asset’s useful life. Further, factors such as asset use, lack of maintenance and the rate of technical and commercial obsolescence may affect useful life.

In addition, agencies must review depreciation methods at least annually and if the expected patterns of consumption of service potential have changed, then the agency must change the method applied to reflect the changed pattern.

Inadequate review of depreciation can produce inaccurate depreciation charges and asset values. It should be the role of experts to determine the useful lives of assets, particularly complex assets, and the patterns of consumption of service potential. Given that agencies identified difficulties in determining accurate useful lives and depreciation methods for long-lived assets, the Committee perceives merit in establishing a mechanism to facilitate the exchange of knowledge and experience among agencies in Victoria and also with counterparts in other jurisdictions.

Further practical guidance from the Department of Treasury and Finance would help agencies resolve implementation issues. While the establishment of typical depreciation rates for assets used in
different industries is encouraged, those rates should be viewed only as a guide.

Accordingly, the Committee recommends that:

**Recommendation 4.1:**

The Department of Treasury and Finance:

(a) provide further detailed practical guidance to agencies on depreciation methods; and

(b) facilitate the exchange of information across agencies so benchmarking of depreciation practices within specific sectors can be established.

Although AAS 4 does not address the ‘lumpiness’ and ‘spikes’ in service potential consumption that sometimes are associated with long-lived infrastructure assets, the Committee understands that accounting standards can accommodate them. Agencies can use the annual review of depreciation, as required by the accounting standard, to determine depreciation that reflects the pattern of consumption of the service potential of assets. Agencies that meet the full intent of AAS 4 are expected to be able to report depreciation that accurately identifies the cost of using the assets for each reporting period.

Given the above, the Committee concludes that the depreciation methods prescribed in the accounting standards are suitable for performance assessment and pricing decisions made within the public sector.

The Victorian public sector has adopted a total asset management framework to ensure assets are used as efficiently and effectively as possible so the Government and the community are afforded the greatest value for money. This means minimising the whole-of-life cost of assets. The experience of agencies is that the accounting rules on depreciation and maintenance, if followed in a disciplined manner, can also provide the necessary information for asset management.

At the local agency level, considerable benefits can be gained from integrating the accounting approach to depreciation with asset
management. The process of annually assessing the useful lives and conditions of assets, technological and commercial obsolescence, the pattern of service potential consumption and remaining service potential is an important part of overall asset management. The information obtained for accounting should provide a useful basis for making decisions on issues such as maintenance planning and funding, and asset acquisitions and disposals.

For effective asset management, agencies’ systems need to have a number of major components, including maintenance plans, depreciation policies and the necessary supporting management information systems that are interfaced with the accounting systems. Agencies should use the asset management systems to:

- plan for, monitor and record maintenance expenditures;
- periodically, over an appropriate cycle, assess the physical condition of the assets; and
- monitor the consumption pattern of the service potential of the assets and the actual consumption in each reporting period.

Accordingly, the Committee recommends that:

**Recommendation 4.2:**

The accounting approach to depreciation be fully integrated into the asset management processes of agencies.

The Committee notes significant divergence in the sophistication of the asset management systems established by agencies across the Victorian public sector. This divergence may be partly due to the ‘let the managers manage’ approach that was adopted in the 1990s.

The Committee considers that the total asset management approach could improve in Victoria, through:

- the establishment of a comprehensive whole-of-government policy framework that is supported by detailed practical guidelines;
the creation of an expert capacity within a particular Department (for example, the Department of Infrastructure) to advise and assist other agencies in resolving asset management issues;

- the implementation of appropriate mechanisms to facilitate the exchange of knowledge, experience and information among agencies; and

- an additional role for the Department of Treasury and Finance, involving monitoring the implementation of the Government policy, because asset management has budget and funding implications.

Accordingly, the Committee recommends that:

**Recommendation 4.3:**

A whole-of-government approach be applied to improve the asset management systems of agencies and to facilitate agencies’ migration to best practice.

### 4.5 Alternative depreciation methods

A few agencies in Victoria expressed the view that accounting depreciation as required by AAS 4 is inappropriate when applied to infrastructure assets that comprise a network intended to be maintained indefinitely. They were concerned that depreciation fails to reflect the amount required to be recognised in the Statement of Financial Performance to ensure sufficient funds are available to maintain the service capability of the network. These agencies suggest renewals accounting as an approach to overcome this perceived deficiency.

Under the renewals accounting approach, agencies regard all expenditures on the asset network, whether for repairs and maintenance or replacements, as being for maintenance of the network. Therefore, the expenditures are recognised as expenses in the period in which they are incurred. Depreciation is not recognised.

This approach assumes that expenditure incurred in maintaining a network adequately represents the cost of the service potential
consumed, that is, the cost of using the asset, during any period. The Urgent Issues Group of the Australian Accounting Standards Board disputes this assumption as can be evidenced by undertaking a condition assessment of the assets at the end of each reporting period.

The Committee noted that the advocates of the renewals accounting approach tend to view depreciation as a process of funding asset replacement rather than as a measure of the service potential consumed in a particular reporting period. In addition, this approach neglects the AAS 4 requirement that agencies account for separate components of the infrastructure where those components are material and have different useful lives.

The Steering Committee on National Performance Monitoring of Government Trading Enterprises evaluated the renewals accounting approach in 1994 in terms of its capacity to provide relevant information for assessing the performance and financial position of Government trading enterprises. The Steering Committee rejected the approach because it assumes the service potential of the system asset is in a ‘steady state’ and does not consider the changing service potential of the component assets. In other words, the approach assumes that all subsequent expenditures on an asset will not increase its service potential beyond that originally assessed but will maintain the service potential at existing levels.

The Department of Treasury and Finance has adopted the policy position that renewals accounting is an inappropriate method to apply to public sector infrastructure assets for accounting purposes, primarily because it does not recognise the cost of the service potential consumed during a reporting period (the key requirement of AAS 4) and thus does not identify the full cost of service provision. In addition, because the method does not record the acquisition of components of infrastructure assets and the depreciation of those assets, the State’s Consolidated Financial Statements would not display the total assets controlled by the State.

Some other agencies and commentators also argued that the depreciation methods conventionally adopted for long-lived
physical assets (including infrastructure assets) are inappropriate for such assets. The arguments included that:

- these assets are complex, have long useful lives and constantly are rehabilitated, so often it is not possible to develop a reliable estimate of their useful lives;
- variations in estimates of an asset’s useful life, the rate of consumption of service potential or residual value can have a major impact on the operating results of an agency;
- it is not possible to distinguish between maintenance expenditure and expenditure to enhance the service potential of an asset beyond that originally assessed. As such, maintenance and depreciation expenses cannot be reliably determined; and
- the information required to implement the depreciation methods under AAS 4 does not align with the information necessary for asset management.

Given these concerns, some public sector agencies, including road authorities and local councils, adopted alternative approaches to the depreciation of long-lived physical assets. These alternative methods often are described as condition-based depreciation (CBD) methods. While CBD methods vary in detail, they usually require a periodic, often annual, assessment of the physical condition of the asset.

The agency then estimates the cost of restoring the asset from its current condition to a predetermined service level. CBD methods recognise any increase in the restoration cost, beyond that estimated in the previous reporting period, as a depreciation expense. In addition, they recognise all expenditures for asset maintenance and refurbishment as an expense in the period in which it is incurred.

In many cases, CBD methods are linked to a detailed asset management plan which incorporates the estimated maintenance, refurbishment and rehabilitation work required to maintain current or required service levels of the asset over the long term (often 20 years or more). Some CBD methods convert the
Chapter 4: Depreciation of cultural, heritage and infrastructure assets

estimated costs of maintaining the asset over this period to an annual annuity.

The agency compares the annuity with the actual maintenance, refurbishment and rehabilitation expenditures incurred during the reporting period. Any shortfall is considered to be the depreciation expense, because it represents a deterioration in the service level of the asset. This depreciation expense, together with the maintenance, refurbishment and rehabilitation expenditures incurred during the reporting period, is recognised in the Statement of Financial Performance as an expense.

Adoption of CBD or similar methods of depreciation can have a significant impact on the operating results of public sector agencies. CBD and other similar methods are claimed to be more useful than the AAS 4 methods for asset management, cost projection, cash flow budgeting and pricing purposes.

The Urgent Issues Group of the Australian Accounting Standards Board investigated the application of CBD methods in 1999 because there were concerns that they may not meet the requirements of accounting standards. As a result, an Urgent Issues Group (UIG) Abstract was issued in January 2000, clarifying the Board’s position. UIG Abstract 30 ‘Depreciation of Long-Lived Physical Assets, including Infrastructure Assets: Condition-Based Depreciation and other Methods’ states that CBD and other methods of depreciation that include any of the following characteristics do not comply with accounting standards AASB 1021 and AAS 4 ‘Depreciation’ and must be discontinued:

- the depreciation expense is not determined by reference to the depreciable amount of the asset;
- the depreciation expense is determined without consideration of technical obsolescence, potential changes in consumer demand and related factors that can influence the consumption or loss of the asset’s future economic benefits during the reporting period;
- expenditure on maintenance and enhancement of the asset’s future economic benefits are not separately identified where reliable measures of these amounts can be determined, and are not recognised as an expense of
the reporting period in which the expenditure was incurred (in the case of maintenance expenditure) or as an asset (in the case of asset enhancement expenditure);

- the asset is presumed to be in a steady state and a renewals accounting approach is adopted, recognising all expenditure on the asset as an expense in the period in which it is incurred without considering whether that expenditure enhances the future economic benefits of the asset; and

- the method does not separately identify major components of complex assets or account for them as separate assets where necessary to reliably determine the depreciation expense of the reporting period.

It appears to the Committee that existing accounting standards, including the recent guidance by the Urgent Issues Group, address most of the depreciation and maintenance cost difficulties identified by the proponents of CBD methods. The accounting rules are quite clear and consistent with those adopted by other major countries.

The Committee acknowledges that the application of a CBD method can provide valuable information about not only the physical conditions of assets but also the costs of restoring consumed service potential. However, these cannot achieve the objective of depreciation as set out in the accounting standard, because they do not capture all the other factors that could reduce the service potential of assets (such as technical and commercial obsolescence). CBD and conventional depreciation methods serve different purposes, but the Committee perceives some merit in integrating the two approaches for asset management.

### 4.6 Other issues of concern

A number of the submissions raised the fact that the existing accounting standards require an asset to be depreciated even when its value is increasing. Arts Victoria noted this point:

*Also, there appears to be an inherent contradiction or futility to depreciating a heritage collection item (such as a European*
painting) over five years only to potentially increase its value when it is revalued again at the beginning of a five year cycle.\textsuperscript{47}

Under the existing accounting framework in Australia, depreciation is separate from periodic revaluation of assets, so agencies need to separately account for the two processes. Depreciation reflects the loss of service potential of an asset in a particular reporting period. Agencies record the monetary value of the loss by allocating a portion of the original cost or revalued amount as an expense for that reporting period. Revaluation, on the other hand, measures the increase in the current cost of the remaining service potential of the asset.

The Committee was informed that the current accounting approach in Australia is the result of the adoption of an ‘entry-value’ model. If an ‘exit-value’ model is adopted, then agencies will not need to separately account for depreciation and revaluation because all changes in the value of assets will be rolled together and reported directly in the Statement of Financial Performance. The Committee was advised that the accounting standard-setters around the world have not yet made a decision on whether the ‘exit-value’ model is appropriate for cultural, heritage and infrastructure assets as there are many difficult conceptual issues involved.

Another issue raised in the submissions is the possibility of agencies attempting to manipulate the depreciation and maintenance expense amounts mainly for financial reporting, funding and pricing purposes. To reduce such manipulation, the Committee considers that the Department of Treasury and Finance should set clear guidelines and that the Auditor-General’s Office should continue to apply a rigorous approach when auditing those two areas.

Accordingly, the Committee recommends that:

**Recommendation 4.4:**

(a) The Department of Treasury and Finance establish clear guidelines on how depreciation and maintenance expenses are to be

\textsuperscript{47} Arts Victoria, submission no. 27, p. 2
determined by agencies for accounting, budgeting and pricing purposes; and

(b) The Auditor-General’s Office continue to apply a rigorous approach when undertaking a financial statement audit on depreciation and maintenance.
Key Findings:

5.1 A total dollar amount reflecting the cost of the initial valuations for the whole Victorian public sector has not been determined.

5.2 Most of the agencies, including the Auditor-General’s Office, consider that the benefits obtained exceed the costs of the initial valuations. However, some of the cultural institutions do not share this view.

5.3 There seems to be a general agreement that the costs of future revaluations should be substantially less because the asset records, valuation methods and management systems are in place. Moreover, the lessons learned from the initial projects should assist in the development of future revaluation processes.

5.4 Agencies indicated that the existing valuation processes could be made more cost-effective by the better sharing of knowledge, experience and information among agencies and also by the adoption of cost minimisation techniques for undertaking revaluations.

5.5 Agencies claimed to have derived many management benefits from the valuation of cultural and heritage assets, but the Committee is concerned that not all cultural institutions have maximised these benefits.

5.6 Obtaining reliable values for certain categories of cultural and heritage assets remains difficult. Agencies and valuers should co-operate to develop rigorous and consistent valuation methods.
5.1 Introduction

For the Victorian public sector, external valuation experts undertook or supervised the asset valuations in many cases. In some instances, the Victorian Valuer-General’s Office was involved in managing the valuation process. Private sector valuers, in conjunction with statisticians, carried out most valuations of cultural and heritage assets, because not all assets were individually valued.

Statistical sampling methods were used to derive a total value for the collection assets, thus minimising the cost of the valuation process. This involved valuing the high-value collection items individually, but selecting only a sample of the large quantum of low-value items and then extrapolating to obtain the value of the total population.

The costs of valuation and the reliability of the asset values obtained are matters of interest to the Committee (term of reference No. 4), as are the benefits of the valuation information to internal agency managers and external stakeholders. The benefits issue is discussed in detail in Chapter 3.

5.2 Cost of valuation

The initial valuation of the cultural, heritage and infrastructure assets across the Victorian public sector was undertaken in the mid-1990s. As part of the valuation process, agencies had to identify the assets and develop appropriate valuation methods. In many instances, supporting asset registers and management systems had to be established for the first time. In other cases, existing recording and decision support capabilities needed to be significantly upgraded.

The Department of Treasury and Finance advised the Committee that a total dollar amount reflecting the cost of undertaking the initial valuation for the whole Victorian public sector has not been determined. Many agencies claimed that the dollar amount relating solely to asset valuation, as distinct from the cost of developing or upgrading asset management systems, would be difficult to isolate and identify.
However, the Committee is interested to note the view of the Victorian Auditor-General’s Office that the initial costs were not excessive relative to the benefits. This also seems to be the view of most agencies in Victoria, except perhaps some of the cultural institutions. The Auditor-General’s Office contended that the cost to continue the valuation process, by periodic revaluations, should be minor because the asset records and the valuation methods and systems are now in place.

Mr Graeme Addicott, Manager of the Darwin Region of the Australian Valuation Office, considered that the costs of valuation should decrease significantly in the future because the documentation, processes and systems have been established and are continually being refined. He noted that the lessons learned from the initial valuations will be instructive in the development of future revaluation strategies.

A few agencies provided the Committee with cost figures for specific valuations. The joint valuation project that included the State Library of Victoria, the National Gallery of Victoria, Museum Victoria, the Public Record Office of Victoria and the Performing Arts Museum, for example, was completed at a total cost to Government of approximately $1.36 million. The Committee understands that this was a prototype project and incorporated all costs, including the cost of identification, documentation and system development. These once-off costs would not need to be incurred again in future revaluations.

Mr Graeme Addicott advised that the Australian National Library, for example, needed to spend only about $50,000 in its valuation and that the actual valuation work took only about three to four months (compared with nearly two and half years for the Victorian project).

To provide the Committee with a broad indication of the costs involved in valuation, the Victorian Valuer-General’s Office advised that it received, over the three-year period to April 2001, a total fee of about $2.4 million for all the valuations carried out for Departments in Victoria. Most of that amount represented fees

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48 Victorian Auditor-General, submission no. 31, p. 12
49 Mr G. Addicott, submission no. 30, pp. 4-5
50 Arts Victoria, submission no. 27, p. 2
paid to private sector valuers who had assisted in the projects. Again, the Committee was informed that part of the $2.4 million fee would have been related to once-off work associated with the system development.  

Mr Balfour, of the Victorian Valuer-General’s Office, and Mr Addicott made useful suggestions to the Committee as to how agencies’ valuation processes could be made more cost-effective in the future. Their proposed strategies include:

- ensuring the asset records and registers, as well as the supporting asset management systems are kept up-to-date;
- ensuring a detailed plan is prepared with input from accountants, asset managers, valuers, statisticians and the Auditor-General’s Office, with all parties sharing a common understanding of the purpose and process involved;
- employing expert valuers from outside to undertake or supervise the valuation if the agency does not have the necessary expertise and/or resources in-house;
- maximising the use of sampling methods in the valuation process based on the advice of expert statisticians;
- using specially tailored indices to update asset values, wherever appropriate, rather than undertaking formal valuations;
- sharing knowledge and experience with other agencies in Victoria and interstate, particularly in relation to assets that are more difficult to value;
- continually refining the valuation process in the light of lessons learned from previous projects; and
- attempting between revaluations to refine the data collection procedures and to raise the standard of documentation.

The view of most agencies in Victoria is that the costs of future revaluations should be substantially less than the costs of the

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51 Mr G. Balfour, transcript of evidence, p. 39
52 Ibid, pp. 31 and 32 and Mr G. Balfour, Valuer-General’s Office, transcript of evidence, p. 37
initial projects. This is mainly because the experience gained from, and the documentation prepared for, the previous projects should lead to greater efficiency in the valuation process.

Accordingly, the Committee recommends that:

**Recommendation 5.1:**

Agencies establish formal arrangements, with the assistance of the Department of Treasury and Finance, to facilitate:

(a) the sharing of knowledge, experience and information on valuation methods across the public sector; and

(b) the development of cost-minimisation techniques for future valuations.

### 5.3 Benefits of valuing cultural assets

During the Inquiry, some cultural institutions expressed concerns about what they perceived to be the excessive costs of valuation relative to the benefits obtained. However, the Committee also received many claims of management benefits that had accrued to agencies as a result of valuing cultural collections. Some agencies argued that the valuation and other related information obtained has assisted decision-making on matters such as:

- the development of appropriate internal management practices for conservation, preservation, record-keeping and security;
- the priority of funding to be directed to conservation and preservation services, storage and security;
- the allocation of new funds among different types of collection asset; and
- the re-allocation of resources to higher priority collections through the sale of existing low-priority assets.

According to some cultural institutions, the valuation exercises undertaken have helped to identify where management practices could be improved in relation to, for example, record-keeping,
preservation and storage. The findings generally have led to a re-evaluation of agencies’ approaches. Further, agencies acknowledged that the valuations have assisted them in managing risks in areas such as security, insurance arrangements and loan transactions.

The Committee is aware that the above claimed benefits would not apply equally to all cultural institutions. The extent of the benefits obtained would depend on the status of record-keeping and the comprehensiveness of the conservation and preservation practices of the individual institutions.

Some cultural institutions argued that the claimed management benefits of valuation could be obtained without assigning a dollar value to the collection assets. Others disagreed, noting that effective decisions regarding the priority and allocation of funding are not possible without an ascription of a dollar value of the items involved.

Some cultural institutions disputed the above claimed benefits of valuation:

*Any steps we have taken towards establishing a financial value of elements of the State Botanical Collection have been taken purely in response to the prospect of having our annual financial report qualified by the Office of the Auditor-General if we do not comply with their requirements. We do not consider the valuation of the State Botanical Collection to be a financially or practically useful exercise in itself.*

*The National Gallery of Victoria has little evidence that the resulting valuations have been used for any major decision-making purposes, thus leaving the issue of insurance valuations as the primary reason for undertaking such tasks. Interestingly however, the National Gallery of Victoria and the valuer have always argued that the existing values reported in the annual financial statements should not be used for insurance purposes.*

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53 Museum Victoria, submission no. 16, p. 3
54 Royal Botanical Gardens of Melbourne, submission no. 13, p. 2
55 National Gallery of Victoria, submission no. 28, p. 4
According to Mr Martin Hallett of Museum Victoria, Museums Australia (the peak industry body) also has strong concern about the process of valuing collection assets and the benefits that flow from it. However, he advised that there is now a much more widespread acceptance by museums around Australia of the need to value such assets, although mainly because valuation is Government policy.\(^56\)

In giving evidence to the Committee, the Victorian Valuer-General made the following observations about the adoption of the deprival value method of valuing cultural and heritage assets:\(^57\)

- the process of asking whether the asset would be replaced if the agency were deprived of it, imposes a useful discipline on the agency to review regularly the continuing relevance of existing assets;
- the replacement cost information is useful in determining depreciation and maintenance requirements; and
- if an asset would not be replaced if the agency were deprived of it, the agency is required to take positive steps to determine the market selling price and also the cost and manner of disposal.

Mr Durham argued that the use of the deprival value method has indirectly imposed a desired discipline on collection managers to monitor regularly the status and relevance of their asset portfolios.\(^58\) The Committee believes that this discipline represents a major, yet unreported, benefit of the valuation process.

The Committee is concerned that not all cultural institutions have maximised the benefits of valuing cultural and heritage assets.

Accordingly, the Committee recommends that:

**Recommendation 5.2:**

*The experience of those cultural institutions that have derived significant management benefits from asset valuation be shared with other institutions with a*

\(^{56}\) Mr M Hallett, Deputy Chief Executive Officer, Museum Victoria, transcript of evidence, p. 31
\(^{57}\) Mr J Durham, Valuer-General Victoria, transcript of evidence, pp. 35-36
\(^{58}\) Ibid
view to maximising the return from the expenditures incurred.

The Committee is aware that cultural institutions in Victoria have all formulated their own collection development and management policies. However, the degree of sophistication of the policies does vary among the institutions. To further maximise the benefits of valuation, the Committee can see merit in the institutions working together to develop a best practice policy framework. This can then be used as a template for adaptation to individual situations to reflect local requirements. The policy framework should contain principles and guidelines on a wide range of matters dealing with collection management, acquisition and de-accession.

Accordingly, the Committee recommends that:

Recommendation 5.3:

The cultural institutions work together to formulate a best practice policy framework on collection development and management so that it can be used as a template for adaptation to the specific requirements of each institution.

5.4 Reliability of valuation

Under the accounting standards, a key criterion for the recognition of an asset in the Statement of Financial Position is that it must have a value that can be measured reliably. Measurement reliability generally is interpreted to mean that any qualified objective person using the same valuation method/process will produce either the same or similar result. The general view of the Australian Accounting Standards Board, the Department of Treasury and Finance and the Victorian Auditor-General’s Office, as well as the Valuers-General around Australia, is that most assets in the public sector can be valued with a degree of reliability that is acceptable for financial reporting and audit purposes.

This reliability factor is pivotal because, under the accounting standards, an asset which can be reliably valued must be recognised in the Statement of Financial Position, whereas an asset which cannot be reliably valued must not be recognised. Instead, a
note to the statement is required, explaining the reasons for not being able to reliably measure the value. The cultural or heritage significance of the items, where applicable, should also be explained.

The Committee was advised of examples of cultural and heritage items that normally cannot be valued reliably, such as archival materials and some archaeological collections and works of art. In the case of archival materials, a market price may not exist because the materials are of a confidential nature and therefore there is no market, or a replacement cost is not available because the materials cannot be replaced (for example, weather records). An example of archaeological collections that cannot be reliably valued is where the historical site no longer exists and therefore the items quite literally cannot be re-collected. Some unique works of art also cannot be re-purchased or replaced because the particular styles are extinct (for example, some Aboriginal paintings).59

A number of agencies, particularly cultural institutions, expressed strong doubts as to the accuracy of the valuation of some assets. The National Gallery of Victoria explained its concern to the Committee in the following terms:

_The cost for the valuation undertaken in 1997 ran into hundreds of thousands of dollars and, whilst not wishing to discredit the organisation responsible, the outcome is extremely questionable in terms of its accuracy._60

Mr Richard Llewellyn of the University of Sydney expressed similar concerns:

_The extent of the inappropriateness of trying to apply AAS 29 has been demonstrated in the valuation of three relatively similar institutions – the National Library, the State Library of New South Wales, and the State Library of Victoria. While the ‘final’ answers are not yet in, indicative valuations all based on deprivational value to meet the requirements of AAS 29 have given results of around $1.8 billion, $2 billion and $180 million. While nobody argues that there are discernable differences__

59 Mr G Addicott, submission no. 30, p. 21 and Royal Botanic Gardens Melbourne, submission no. 13, p. 3
60 National Gallery of Victoria, submission no. 28, p. 4
between the collections of these three institutions, such a spread of valuations defies any rational explanation.\textsuperscript{61}

The Committee was also informed that there is a significant difference between the valuation figures obtained for Museum Victoria ($211 million for 16 million items) and the Australian Museum ($3,047 million for 27 million items).\textsuperscript{62} Apparently, the difference may be due to a number of factors, including:\textsuperscript{63}

- the size of the collections and the intrinsic value of the content; and
- differences in the assumptions about the cost of re-collecting the items.

The Committee noted an article published recently in the Melbourne \textit{Herald Sun} (7 September 2002) reporting a massive increase in the total value of the collections held by the National Gallery of Victoria from $615 million (in 1997) to $1.8 billion. According to the article, the increase in value was mainly due to a sharp rise in the international market. The experience of the National Gallery of Victoria, in the Committee’s view, serves to illustrate the high degree of volatility of market value that can sometimes occur with collection assets.

Past attempts by a few cultural institutions around Australia to artificially inflate the value of collection assets for prestige and funding purposes were also raised as an issue with the Committee. In an article written by Ms Jennifer Byrne and published in \textit{The Age} Magazine (7 September 2002), the following comments (attributed to Mr Graeme Addicott of the Australian Valuation Office) were quoted:

\textit{… Once we got down to it, the museum people were far from reluctant, they exerted a great deal of pressure on the valuers to come up with big figures. The whole process got out of hand – it became a matter of ‘mine’s bigger than yours’}.\textsuperscript{64}

The same article also gave examples of valuations that have been ascribed to a number of famous museum collections:

\textsuperscript{61} Mr R Llewellyn, University of Sydney, submission no. 14, p. 1
\textsuperscript{62} Museum of Victoria, submission no. 16, p. 5
\textsuperscript{63} Ibid
\textsuperscript{64} Ibid
Phar Lap’s heart, which hasn’t been anywhere of late, also has a price tag: $1 million. The sum of $500,000 has been ascribed to the Azaria Chamberlain collections, including baby Azaria’s infamous black dress.

A Tasmanian tiger pelt has been valued at $45,000; a tiger carcass at $200,000. And after 10 years in the Darwin mangroves, the Hong Hai, the boat that carried the first load of Vietnamese refugees to Australia, 38 desperate souls, now carries an impressively high valuation of $1.5 million.

The sampling approaches adopted by the cultural institutions in valuing the collection assets was a matter which attracted the particular attention of the Committee during the Inquiry. In the case of Museum Victoria, the Committee was told that Monash University was engaged to assist in establishing the sampling process for the 1996 valuation. The method chosen was ‘stratified multi-stage cluster sampling’ and it had the endorsement of both the Auditor-General and the Department of Treasury and Finance.

At the hearing, Mr Martin Hallett of Museum Victoria, gave the Committee a brief outline of the process involved:

... the process is one that uses a small sample size to get a reliable outcome. That is why we selected it. We need to set up strata which are things that have common storage, common value and common nature. For instance, we would go into a storage area, look for material which can be characterised as a type, and then that is set up as a stratum. I think in the sampling we did last time we had a total of about 150 strata across the 16 million collection items.64

The Committee was informed that the total value of all of Museum of Victoria’s collection assets was determined at $211 million in 1996 using a sample size of about 4,000 items.

Apart from the problems of selecting suitable samples from a diverse range of items (as in the case of museums), Mr Hallett also highlighted to the Committee a major inherent limitation of the sampling process:

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64 Mr M Hallett, Museum of Victoria, transcript of evidence, p. 33
I think the other reason why one needs to be cautious with the sampling process with museum collections is that one single item, if missed, could make a significant difference. In the museum world, a single painting could be worth tens or hundreds of millions of dollars...the problem there is that a valuer can only attribute value on the basis of what is known.65

From the evidence obtained during the Inquiry, the Committee cannot help but conclude that the sampling processes currently used by the cultural institutions for collection assets are fraught with problems mainly because of the arbitrariness involved, the diversity of the items and also the inherent limitations of sampling. This is an area that should receive the continuing attention of the institutions with a view to further improving the accuracy of the process.

In the debate about the valuation of cultural and heritage assets, the Committee noted that some cultural institutions and academic commentators tend to argue that those assets, as a group, are too difficult and costly to measure and that the information generated does not serve any useful purpose. The Committee perceives some merit in Mr Frank Micallef’s suggestion for tackling the practical problems:

> It is not a solvable problem on a global basis, and therefore it needs to be broken down into projects that can be dealt with expeditiously, efficiently, and also with input from the interested parties rather than it turning into a process which ends up being drawn out, costly and which consumes a lot of people's time.66

Mr Micallef, previously a senior Project Director with the Australian Accounting Research Foundation, has had significant involvement in resolving asset valuation issues with public sector agencies and valuers over many years.

The existing practical problems and inconsistencies serve to highlight the difficulties that agencies, particularly cultural institutions, face in seeking to determine a reliable value for some categories of assets. More consistent and rigorous methods need to

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65 Ibid, p. 34
66 Mr F Micallef, transcript of evidence, p. 81
be developed. The Committee considers that this development requires the co-operative effort of the Valuers-General across Australia, as well as input from valuation experts in the private sector. The Auditors-General can also assist by, for example, benchmarking the valuation methods of the various jurisdictions in their audit processes.

A submission from Mr Grame Addicott drew the Committee’s attention to another issue, namely the lack of agreement among agencies and valuers as to the implications of categorising assets incapable of reliable measurement. The submission pointed out that there will always be a few items within a cultural or heritage collection that cannot be reliably measured under the deprival value method.

Collection material is collected for its cultural, scientific and historic interest. In some rare cases, the collection material may not be replaceable (that is, another item cannot be purchased or produced) and has no acceptable substitute. Similarly, given the volatility of the market for a particular item, a valuer may envisage the need to apply a valuation within a particularly wide range. Such a wide range may raise doubts as to the reliability of the assessed valuation.67

The submission suggested, for cases in which doubt exists, that the valuation process should report the lowest possible value and the highest possible value, as well as the most likely value. If the extent of the range exceeds the lowest possible value by 33.33 per cent, then the item should be regarded as ‘not capable of reliable measurement’. However, the submission emphasised that this classification should not be applied on the basis of an unsubstantiated opinion. In other words, it should not be an easy option; it should be supported by the relevant valuer’s certification that:68

- no established secondary market (either locally or internationally) exists from which an appropriate replacement can be purchased;

67 Mr G Addicott, submission no. 30, p. 33
68 Ibid, p. 34
the range of possible values that can be applied to the item is so wide that any nominated value cannot be supported with confidence;

- it is not possible to establish the costs of re-collecting a substitute item; and

- the item generates no identifiable, regular cash flows, which could be discounted to establish a reliable net present value.\textsuperscript{69}

The submission also pointed out that the lack of reliable measurement does not imply that the cultural or heritage asset has no value; rather, it is literally invaluable. Neither is it a reflection on the valuer’s skills. Rather, a reliable deprival value simply cannot be assessed for that particular item.\textsuperscript{70}

The difficulty in obtaining reliable values for certain categories of cultural and heritage asset remains an issue. This will require agencies and valuers working together to develop rigorous and consistent valuation methods. In this regard, the experience of other jurisdictions could provide useful information that may assist in resolving the practical issues involved.

Accordingly, the Committee recommends that:

**Recommendation 5.4**  
*Agencies and valuers co-operate to develop, if possible, rigorous and consistent methods to obtain reliable valuations of certain categories of cultural and heritage assets.*

**Recommendation 5.5**  
*An independent expert valuer confirm, by certificate, an agency’s opinion that a particular category of cultural or heritage assets is not capable of reliable valuation.*

\textsuperscript{69} Ibid
\textsuperscript{70} Ibid
CHAPTER 6: REPORTING PRACTICES IN MAJOR OVERSEAS COUNTRIES

Key Findings:

6.1 Some countries have established a separate set of institutional arrangements for formulating accounting standards for the public sector similar to those in Australia. Others have applied the private sector accounting standards to the public sector, with minor adaptations in some cases.

6.2 The asset valuation approaches around the world are a mixture of historical cost and current value. Further, the Committee noted that the Governments in the United States, Canada and United Kingdom have not adopted a comprehensive approach to asset valuation, unlike the Australian and New Zealand Governments, which require all assets within the public sector to be valued with no exceptions. In accounting for depreciation and repairs and maintenance, the methods adopted are fairly consistent among the major countries.

6.3 In the United States, the federal and State/Local Government sectors have adopted separate accounting standards. In the federal arena, all ‘general property, plant and equipment’ used to provide Government services are required to be valued at historical cost. For heritage assets that are used to facilitate Government operations, entities are required to capitalise only the costs of renovation, improvement, restoration and reconstruction that can be directly related to those operations. The cost of acquiring or constructing the heritage assets is to be recognised as an expense. The acquisition cost of ‘stewardship land’ (for example, land in public domain, national parks etc.) is also to be treated as an expense and not an asset.
Key Findings (continued)

6.4 In the State/Local Government sector in the United States, the ‘capital assets’ of a Government entity are required to be valued at historical cost. Government entities are encouraged, but not required, to value collection assets at historical cost if they are held for public exhibition, education or research as part of a public service. The conventional depreciation methods are prescribed, except for infrastructure assets, for which an alternative approach is allowed. This approach essentially involves recording, as a substitute for depreciation, the expenses incurred to preserve the condition of the assets.

6.5 All ‘tangible assets’ held by Government entities in Canada are required by the public sector accounting standards to be recorded at historical cost. The valuation of works of art and historical treasures is not mandatory.

6.6 In the United Kingdom, the HM Treasury requires Government agencies to value their ‘tangible fixed assets’ at the lower of replacement cost and recoverable amount. The two main exceptions, which need not be valued, are non-operational heritage assets (for example, museum and gallery collections) and non-operational land and buildings. For road networks, renewals accounting may be used as a method of approximating depreciation.

6.7 Within the European Union, all member countries are required to adopt specific accounting directives to enhance the harmonisation of financial reporting. Cost is the basic measurement principle under the directives, although revaluation is allowed. The approach adopted in France, Germany and Italy for asset valuation is a mixture of cost and current value. Individual Governments determine the accounting requirements for the public sector. Most of the Governments have not yet
adopted full accrual-based financial reporting along the lines of New Zealand and Australia.

Key Findings (continued)

6.8 The public sector accounting standards in New Zealand specify the application of the ‘fair value’ method for valuing property, plant and equipment. The accounting standards provide no specific guidance for valuing heritage assets that do not meet the definition of property, plant and equipment. The practice is to recognise all heritage assets, and the valuation methods adopted are similar to those in Australia.

6.9 Under the South African accounting standards, the cost method is the benchmark treatment for the valuation of property, plant and equipment. Revaluation is allowed as an alternative.

6.10 From its review of overseas financial reporting practices, the Committee has concluded that there is a strong case for exempting not only collection assets but also ‘stewardship land’ from valuation, given cost-benefit considerations. The Australian Accounting Standards Board therefore should be requested to re-examine, under the international convergence initiative, the current Australian requirement for public sector agencies to value collection assets and stewardship land (including national parks and reserves and other Crown land).

6.1 Introduction

A term of reference of the Inquiry was to examine the financial reporting requirements for cultural, heritage and infrastructure assets in other major overseas countries such as the United States, Canada and the European Union, and to determine the need for alternative approaches to valuation methods in Australia. Over the
past ten years, most of the major countries around the world implemented a significant program of financial management and accountability reforms for the public sector. A key element of the reforms was the adoption of commercial accounting principles for preparing Government agencies’ financial reports.

Some countries have established a separate set of arrangements for formulating special accounting standards for the public sector similar to those in Australia. Others have applied the private sector accounting standards to the public sector, with minor adaptations in certain cases. Most of the countries are at different stages of implementing their reform programs, with Australia being one of the countries at the forefront, particularly in financial reporting. Set out below is an examination of the financial reporting requirements for cultural, heritage and infrastructure assets in other major overseas countries.

6.2 Financial reporting practices in other countries

6.2.1 United States

In the United States, the function of setting accounting standards for the Federal Government is vested in the Federal Accounting Standards Advisory Board. Statement of Federal Financial Accounting Standard (FFAS) No. 6 ‘Accounting for Property, Plant and Equipment’ prescribes the relevant accounting standards applicable to federally owned property, plant and equipment. Under the standard, ‘general property, plant and equipment’ (defined as those used to provide general Government services and goods) are required to be valued at historical cost, with depreciation calculated by conventional methods.

FFAS 6 states that heritage assets may include property, plant and equipment that have historical or natural significance, cultural, educational or artistic importance, or significant architectural characteristics, and that are not used in day-to-day Government operations. It requires all expenditures incurred to acquire, construct, reconstruct or improve such assets to be reported as an expense. In other words, these assets are not to be included in the Statement of Financial Position.
For those heritage assets used to facilitate Government operations, only the costs of renovation, improvement, restoration and reconstruction that can be related to Government operations directly (for example, modification or improvement of office space, and upgrading of electrical or communications equipment/wiring) are to be recognised as assets and depreciated over the period for which they are expected to provide a service or produce goods. The cost of acquiring or constructing the heritage assets is to be recognised as an expense.

For ‘stewardship land’ (for example, land in the public domain and national parks or national forest land), FFAS 6 requires the acquisition cost to be reported as a cost in the period incurred. The land is not to be shown in the Statement of Financial Position. FFAS 6 has not provided any guidance on the valuation of collection assets held by cultural institutions in the public sector, because the scope of the accounting standard is confined to property, plant and equipment.

The body that is responsible for developing accounting standards for the state/Local Government sector in the United States is the Government Accounting Standards Board (GASB). The accounting requirements for capital assets are set out in GASB Statement 34 ‘Basic Financial Statements and Management Discussion and Analysis for State and Local Governments’.

Under GASB Statement 34, the capital assets (including infrastructure assets) of a Government entity are to be valued at historical cost or estimated historical cost. Government agencies are encouraged, but not required, to value a collection asset at historical cost, or at fair value if acquired by donation, if the collection is:

- held for public exhibition, education or research to further public service rather than financial gain;
- protected, kept unencumbered, cared for and preserved; and
- subject to an organisational policy that requires the proceeds from sales of collection items to be used to acquire other items for collections.
For those Government entities that have opted not to value their collection assets, certain specified information is required to be disclosed in the financial statements.

For depreciation, GASB Statement 34 gives Government entities a choice of adopting either the conventional depreciation methods or an alternative modified approach (as a substitute to depreciating infrastructure assets). To use the modified approach, the Government entity must manage the eligible infrastructure assets using an asset management system that complies with the characteristics specified in GASB Statement 34. Further, the Government entity must document that the eligible infrastructure assets are being preserved approximately at (or above) a condition level that the Government establishes and discloses. GASB Statement 34 considers that the total dollar amount spent to preserve the condition of those assets should approximate the monetary value of the loss of service potential (that is, the depreciation expense) that would have been reported.

The modified approach is allowed as an alternative because depreciation of infrastructure assets based on historical cost has shortcomings, such as the fact that the calculated depreciation expense does not accurately reflect the current cost of using the assets.

For collection assets, GASB Statement 34 states that the assets, if they are exhaustible (such as exhibits whose useful lives are diminished by display or educational or research applications), should be depreciated over their estimated useful lives. Depreciation is not required for collection items that are inexhaustible.

The Financial Accounting Standard Board is responsible for setting accounting standards for the private sector. The Committee noted that the Statement of Financial Accounting Standard (SFAS) No. 116 ‘Accounting for Contributions Received and Contributions Made’ deals with the valuation of collection assets in the private sector in the United States.

Under SFAS No. 116, the valuation of collection assets is encouraged but is not mandatory. The Board’s view is that collection items are assets and thus have the common
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characteristics possessed by other assets (that is, the scarce capacity to provide services or benefits to the entity that uses those items). The Board considers, therefore, that capitalisation of collection assets is conceptually the proper accounting approach. It allows the alternative of non-capitalisation only as a result of mainly cost-benefit considerations.

The Committee understands that the prevailing practice in the United States is not to capitalise collection assets but to report their acquisition expenditure as an expense when they are purchased. For those entities that have capitalised collection assets, depreciation accounting practices normally are not followed because those assets are deemed to have extremely long useful lives and generally increase rather than decrease in value over time. However, where the carrying value of the assets is determined to significantly exceed their current market value, for example, where an exhibit has only a limited display life, those assets are required to be depreciated.

Library collections normally are valued and depreciated because books are regarded as having limited useful lives. However, where a library has a collection that is expected to maintain its value over a considerable period of time, depreciation is calculated at a reduced rate (or, in the case of rare books with perpetual value, not recorded at all).

6.2.2 Canada

In Canada, a separate body, the Public Sector Accounting Board, is responsible for formulating recommendations and guidance on matters of accounting for the public sector. The Board operates under the auspices of, and is funded by, the Canadian Institute of Chartered Accountants.

Public Sector Accounting Recommendations PS 3150 ‘Tangible Capital Assets’, sets out the reporting requirements for tangible capital assets. The accounting recommendations prescribe that tangible assets are to be recorded at historical cost. Those assets with a limited useful life must be amortised (that is, depreciated) using one of the conventional depreciation methods. The amortisation period for a tangible capital asset is required to be limited to 40 years unless a Government entity can estimate and
clearly demonstrate that the useful life of the asset is expected to exceed 40 years.

PS 3150 states that works of art and historical treasures need not be recognised as tangible capital assets in the financial statements because the Board does not believe that a reasonable estimate of the future benefits of such assets can be made. However, the existence of such assets is required to be disclosed in the financial statements. Further, the Canadian Institute of Chartered Accountants’ Accounting Handbook states that the capitalisation of collection assets is not precluded but is not required.

6.2.3 European Union

The European Union requires all member countries to adopt specific accounting directives to harmonise financial reporting among members.

Two main directives deal with accounting matters. The Fourth Directive covers issues relating to the preparation of the accounts of individual companies (including asset valuation rules). The Seventh Directive is concerned with consolidated accounts for company groups.

Under Article 32 of the Fourth Directive, cost is the basic measurement principle. This is confirmed in Article 35 in its application to fixed assets. However, Article 33 allows member countries to permit or require the revaluation of tangible fixed assets. Where this option is applied, Article 33 requires the difference between the cost and revalued amount to be transferred to a separate balance sheet reserve, known as the ‘revaluation reserve’. The article also provides that transfers to the profit and loss account from the revaluation reserve may be made only to the extent that the amounts transferred are entered as charges in the profit and loss account or that they reflect increases in value that have been realised.

Article 35.1(b) of the Fourth Directive requires fixed assets with a finite life to be systematically depreciated over that life. According to Article 35.1(c)(bb), fixed assets must be written down where any permanent diminution in their value has occurred.
The European Commission currently has a proposal to modernise the accounting requirements of the Europe Union and, in particular, to align the requirements with International Accounting Standards. This is expected to lead to the adoption of the ‘fair value’ method of asset valuation.

Individual Governments determine the accounting requirements for the public sector in Europe. Most Governments have not yet moved to adopt full financial reporting along the lines of other Western countries. Set out below is a brief outline of the accounting requirements for fixed assets in four European Union member countries. In the United Kingdom, the HM Treasury has established a special regime for financial reporting in the public sector. This reporting regime involves specific rules for the accounting of infrastructure and heritage assets.

6.2.4 United Kingdom

In 1996, the UK Government established the Financial Reporting Advisory Board to oversee the implementation of the HM Treasury’s Resource Accounting Manual, which sets out how Government Departments are to prepare their resource accounts. The Board’s role is to ensure the manual follows generally accepted accounting practices in the United Kingdom ‘to the extent meaningful and appropriate in the public sector context’.  

The principal objective of the resource accounting reform initiative was to introduce the best commercial practice into Government accounting. Accrual accounting principles, standards and practices underpin the concept of resource accounting. In 1998-99, Government Departments prepared ‘dry run’ (that is, unpublished) accrual financial statements for the first time. Full accrual accounting and budgeting (that is, resource accounting and resource budgeting) was introduced, for the first time in the 2000-01 financial year.

According to the manual, all tangible fixed assets are to be valued at the lower of replacement cost and recoverable amount (subject to a few exceptions). The purpose of this valuation approach is to determine the value of the assets to the business (a concept similar

to ‘deprival value’). Recoverable amount is defined as the higher of net realisable value and value in use. Assets surplus to requirements are to be valued on the basis of open market value, less any directly attributable selling costs, where material.

The replacement cost for operational land and buildings is the ‘existing use value’. Other (non-property) operational assets are to be valued using open market value where possible. Where market value is not obtainable, these assets are to be valued on the basis of depreciated replacement cost.

In the case of non-operational land and buildings, valuation is not mandatory because the HM Treasury considers that if asset managers already receive adequate information on asset condition and maintenance backlog to fulfil their stewardship role and are unable to dispose of the asset, the benefits of obtaining the information on value are lessened.

The manual requires the asset values to be reviewed annually and, where an asset’s value has changed materially, adjusted accordingly. This assessment is to be conducted via a mix of professional valuation and the application of appropriate price indices, depending on the nature and types of asset. There is a specific requirement for land and buildings to be subject to professional valuation at intervals of not more than five years. The valuation is expected to be adjusted in the intervening years, if appropriate, to account for movements in prices since the latest valuation.

Heritage assets are defined in the manual as including historical buildings, archaeological sites, military and scientific equipment of historical importance, and works of art. The manual states that there are the same benefits, in principle, from valuing heritage assets as from valuing other assets, namely:

- to inform the public about the value of assets held on its behalf;
- to encourage good stewardship of the assets by the owner entity;
- to inform decisions about whether resources are being used appropriately;
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- to distinguish capital and current expenditure; and
- to inform decisions about how much to spend on maintaining the assets by ensuring both value and deteriorations in value are recognised.

All operational heritage assets are required to be valued. These are assets used to provide services in addition to being held for their heritage characteristics. The manual notes, however, that the valuation of non-operational heritage assets may not be practicable or appropriate in some instances, for example:

- where the asset can be valued but the cost of obtaining that value is not warranted in terms of the benefits of the valuation; or
- where it is impossible to establish a sufficiently reliable valuation (such as for a work of art where no similar asset recently has been traded in an ‘arm’s length’ transaction).

In view of the above, the manual specifies that the following categories of non-operational heritage assets need not be valued if an agency is satisfied that the costs of valuation will exceed any benefits that are likely to be obtained:

- museum and gallery collections and other collections, including the national archives; and
- archaeological sites, burial mounds, ruins, monuments and statues.

The Committee was informed by the HM Treasury that no agency in the United Kingdom has opted to value their non-operational heritage assets following cost-benefit considerations.

The manual, however, specifies that the costs of all new purchases of non-operational heritage assets are required to be capitalised (i.e. shown on the Statement of Financial Position as assets). For those non-operational heritage assets that have not been valued, sufficient descriptive disclosures must be included in the notes to the accounts to enable a reader to appreciate the age and scale of the assets, how they were acquired and what use is made of them. The notes also must provide details of in-year acquisitions, in terms of both donated and purchased assets.
Antiques and other works of art that do not meet the definition of heritage assets are to be valued on the basis of open market value determined by a professional valuer at least once every five years. Further, the valuations are required to be adjusted by indexation in the intervening years.

Non-operational heritage assets that have been recognised are to be valued on the following basis:

- where there is a market in assets of that type, at the lower of depreciated replacement cost and net realisable value;
- or
- where there is no market in assets of that type, at depreciated replacement cost unless the asset could not or would not be physically reconstructed (in which case, it should be valued at nil).

The manual adopts the conventional depreciation methods for tangible fixed assets. However, for road networks, it states that renewals accounting may be used as a method of approximating depreciation, provided the renewals expenditure does not materially vary from the monetary value of the consumption of service potential during the year. If the variance is material, then the carrying amount of the asset must be adjusted accordingly.

Where renewals accounting has been adopted, an annual condition survey must be undertaken to assess the overall condition of the road network, so as to determine the consumption of service potential during the year. If the condition survey reveals that the network has been maintained in a steady state since the previous survey, then the renewals expenditure is an acceptable proxy for the depreciation charge. However, if the condition of the network has deteriorated/improved between condition surveys, then the value of the impairment/ improvement, if material, is required to be charged/credited to the operating cost statement.

According to the manual, renewals accounting also may be applied to calculate depreciation for other assets under certain circumstances.
6.2.5 France

A mixture of law and Government decree governs accounting in France. In addition, the professional accounting body issues guidelines and recommendations on Generally Accepted Accounting Practice. Land and buildings are required to be shown at cost in the financial statements, although revaluation is allowed if carried out in accordance with revaluation laws or by a decision of management. However, revaluation is not permitted for machinery, fixtures and fitting.

The accounting rules relating to repairs and maintenance are similar to the Australian accounting standards. For depreciation, the general approach is similar to that in Australia, except for revalued assets. The additional depreciation for revalued assets is required to be neutralised by the reversal of unrealised gains from the special provision created for revaluation.

6.2.6 Germany

Law regulates accounting in Germany, with the Institute of Auditors issuing pronouncements to interpret the law and to fill the gaps not covered by specific legislative provisions. All fixed assets are required to be valued at cost. The cost amounts are not to be adjusted unless the asset has declined in value. The accounting requirements relating to depreciation and repairs and maintenance are similar to those in Australia.

6.2.7 Italy

The accounting framework in Italy is underpinned by legislation and other accounting requirements promulgated by the National Commission of Companies and Stock Exchange (a Government body) and the National Council of Auditors. The legislation requires property, plant and equipment to be shown at cost or revalued amounts in the financial statements. For depreciation, the Civil Code recommends the straight-line method, although other methods are allowed.
6.2.8 **New Zealand**

The accounting standard that deals with the accounting for cultural, heritage and infrastructure assets in New Zealand is Financial Reporting Standard (FRS) No. 3 ‘Accounting for Property, Plant and Equipment’. The Financial Reporting Standards Board of the Institute of Chartered Accountants in New Zealand issued this standard, which was approved in March 2001 by the Accounting Standards Review Board under the *Financial Reporting Act 1993*.

FRS-3 has adopted the ‘fair value’ method for valuing assets and specifically refers to both infrastructure and heritage assets. According to the standard, ‘fair value’ is to be determined using either market-based evidence or depreciated replacement cost (if reliable market-based evidence is not available). The accounting standard requires the revaluation of assets to be carried out at least once every five years by either an independent valuer or an experienced employee.

The accounting standard also states that ‘heritage assets that meet the definition of property, plant and equipment are to be accounted for in accordance with the standard’. It gives no specific guidance for the accounting of heritage assets that do not meet the definition of property, plant and equipment. The current practice within the public sector in New Zealand is to recognise heritage assets. While acknowledging significant difficulties with valuing certain heritage assets, the sector has used the following methods of valuation:

- the best estimate of net current value of archives in the possession of National Archives;
- estimated net current values of heritage library collections;
- sales evidence of land in the same general location with comparable topography and vegetation cover to value national parks, forest parks and conservation areas (with such valuations adjusted downwards to reflect restrictions on the use of national parks and the smaller areas in private sales); and
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- the depreciated replacement cost of the parliamentary library.

FRS-3 specifies that the conventional depreciation methods are to be applied to property, plant and equipment. The commentary section of the standard states that the use of an asset management plan and the expensing of all expenditures on repairs and maintenance do not negate the requirement to charge depreciation. Further, it points out that the so-called ‘long-run-average-renewals-approach’ adopted by some entities for infrastructure assets cannot be applied as a substitute for depreciation.

### 6.2.9 South Africa

In South Africa, the Accounting Practices Board of the South African Institute of Chartered Accountants is responsible for issuing Statements of Generally Accepted Accounting Practices. Companies are required to follow these statements, as well as the relevant provisions of the Companies Act.

The Statement of Generally Accepted Accounting Practices dealing with property, plant and equipment specifies the cost method as the benchmark treatment, allowing revaluation as an alternative. Where the revaluation option is chosen, assets are to be valued at fair value (that is, the market value or depreciated replacement cost), particularly for specialised assets. The depreciation approach is based on the conventional methods.

### 6.3 Conclusions and recommendations

The Committee undertook an extensive review of the financial reporting practices for infrastructure and heritage assets in other major overseas countries. It found that some countries such as the United States, Canada and the United Kingdom have established a specific reporting regime for the public sector instead of applying private sector accounting standards.

The asset valuation approaches adopted by a number of major overseas countries are a mix of historical cost and current value. The positions of the major countries may be summarised as follows:
- United States and Canada – historical cost basis.
- United Kingdom and New Zealand – current value basis.
- European Union (except for the United Kingdom) and South Africa – historical asset or current value basis.

The Committee notes that the Governments in the United States, Canada and the United Kingdom have not adopted a comprehensive approach to asset valuation, whereas the Australian and New Zealand Governments require all assets within the public sector to be valued without exception.

In the United States, Federal Government entities are exempt from valuing certain types of assets. For example, the cost of acquiring or constructing a heritage asset is not to be capitalised; instead, it is treated as an expense. Another example is ‘stewardship, which is also not required to be valued and included in the Statement of Financial Position. Both the United States and Canada encourage, but do not require, the valuation of collection assets. In the United Kingdom, certain types of assets are exempt from valuation. The valuation of non-operational land and buildings is not mandatory, and certain categories of non-operational heritage asset (for example, museum, gallery and other collections) are not required to be valued.

In accounting for depreciation and repairs and maintenance, the Committee’s review showed that all major countries have adopted the conventional methods. As an example of an exception, the State/Local Government entities in the United States are permitted to adopt an alternative ‘modified approach’ as a substitute for depreciating infrastructure assets, subject to compliance with certain conditions. This approach involves an annual determination of the costs to preserve the condition of the assets at a pre-determined level. In the United Kingdom, a form of renewals accounting is allowed as a substitute for depreciating the road networks.

The Committee was informed that accounting standard-setting bodies in Australia have previously considered the application of condition-based depreciation and renewals accounting to the Australian public sector. Following extensive consultation, the Urgent Issues Group issued general guidance in January 2000 by
releasing Abstract No. 30 ‘Depreciation of Long-Lived Physical Assets, including Infrastructure Assets: Condition-Based Depreciation and Other Methods’.

The Committee’s view is that if Government agencies in Victoria, particularly those with extensive infrastructure assets, genuinely believe that an alternative form of depreciation (such as condition-based depreciation) is more appropriate to their circumstances, then they should seek guidance from the Department of Treasury and Finance and the Australian Accounting Standards Board.

From the review of overseas financial reporting practices on asset valuation and other related issues, the Committee has concluded that there is a strong case for exempting ‘collection assets’ and ‘stewardship land’ from the valuation requirements in Australia. The case for the exemption of ‘collection assets’ is set out in detail in Section 2.5 of Chapter 2. Land assets that are under the stewardship control of agencies normally include the land components of national parks and reserves and other Crown land. As at 30 June 2001, the total value of national parks and reserves was about $500 million.

In the Committee’s view, the benefits of valuing ‘stewardship land’ in the context of assessing performance and stewardship are minimal for the following main reasons:

- ‘stewardship land’ is rarely redeployed or sold (unlike infrastructure assets), and generally there are no asset management decisions to be made using the information about the value of the land assets;
- ‘stewardship land’ is not a depreciable asset and therefore its recognition has no bearing on the cost of services recognised in the financial reports (e.g. depreciation and maintenance expenses);
- information about the current value of ‘stewardship land’ could be misinterpreted by the public as the amount that could be obtained from the sale of that asset to finance the operations of the business;

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72 Department of Treasury and Finance, 2000-01 Financial Report for the State of Victoria, p. 89
‘stewardship land’ normally does not generate cash flows directly and, because of this, information about its current value is irrelevant to pricing decisions; and

the value of ‘stewardship land’ is not useful for assessing an agency’s performance in delivering services because the value is not affected by the agency’s effectiveness in asset management.

Accordingly, the Committee recommends that:

**Recommendation 6.1:**

The Australian Accounting Standards Board be requested to re-examine, under the international convergence initiative, the current Australian requirement for public sector agencies to value ‘stewardship land’, including national parks and reserves and other Crown land.

Irrespective of whether the value of ‘stewardship land’ is included in the financial statements, the Committee is firmly of the opinion that the agencies responsible should provide appropriate stewardship information in the statements covering such matters as the quantum and condition of the land assets, details of maintenance and preservation work undertaken and the associated costs.

Accordingly, the Committee recommends that:

**Recommendation 6.2:**

Those agencies holding ‘stewardship land’ be required to include additional stewardship information in the annual financial statements covering such matters as the quantum and condition of the land assets, details of maintenance and preservation work and associated costs.
7.1 Introduction

Agencies are required to value all cultural, heritage and infrastructure assets with no exceptions.

The previous valuations were undertaken based on the ‘deprival value’ method. As a result of the issue of the recent new accounting standard, future valuations will be required to be conducted in accordance with the ‘fair value’ method. The implications of the change have yet to be fully articulated by the Australian Accounting Standards Board and the Department of Treasury and Finance. However, the Committee understands that the valuation experts generally believe that ‘fair value’ and ‘deprival value’ should be calculated in the same way in most cases.

In the Committee’s view, the detailed guidance to be provided by the Board and the Department of Treasury and Finance on the change in valuation methodology could be employed to advantage in addressing any lingering concerns and inconsistencies in the valuation of assets.

7.2 Comparison with overseas reporting practices

In recent years, the Governments of other major overseas countries have implemented financial reporting reforms similar to those in Australia. The asset valuation approaches used around the world are a mixture of historical cost and current value. The North American countries still use the historical cost method, while Australia, New Zealand and the United Kingdom, for example, have adopted the current value (or ‘fair value’) method.

Another important observation is that the United States, Canada and the United Kingdom have decided not to adopt a comprehensive approach to asset valuation whereas Australia and New Zealand require the valuation of all assets within the public
sector without exceptions. In the United States, certain assets of the Federal agencies – such as heritage assets that are not directly related to the provision of Government services as well as ‘stewardship land’ and collection assets – are not required to be valued. In the United Kingdom, Government agencies also do not have to value particular categories of assets, including non-operational land and buildings, and collection assets.

The new International Public Sector Accounting Standard (IPSAS) 17 on ‘Property, Plant and Equipment’ adopts a similar non-comprehensive approach to asset valuation. The Public Sector Committee of the International Federation of Accountants (IFAC) introduced the accounting standard in December 2001. Under the new standard, the recognition of heritage assets is not mandatory at this stage. The Committee has been informed that the IFAC’s Public Sector Committee intends, as part of its work program, to consider the measurement of heritage assets particularly the development of reliable valuation methods that are acceptable to IFAC member countries. IPSAS 17 has given member countries a five-year implementation period to progressively value their assets and include them in the financial statements.

The Committee’s Inquiry identified at least two major countries, the United States and the United Kingdom, that allow alternatives to the conventional methods of depreciation for infrastructure assets in certain circumstances. The main reason given for the departure from conventional methods is that other methods of measuring the consumption of service potential may be more appropriate given the special characteristics of infrastructure assets. The Committee, therefore, urges the Australian Accounting Standards Board to review its existing accounting standards on depreciation, and take into account the practices in other major countries.

The future development of international public sector accounting standards is relevant to Australia, because the Australian Accounting Standards Board (along with all other major standard-setters) has committed to achieve, over time, convergence with those standards. The international standards are intended to provide a minimum benchmark for the Governments of IFAC
Chapter 7: Asset valuation – the way forward

member countries to enhance the quality and comparability of financial reporting in the public sector around the world.

Given the Commonwealth Government’s commitment to achieve convergence with international accounting standards by January 2005, it is important that the Australian approach to asset valuation and depreciation be closely aligned with those of other major overseas countries and also with the International Public Sector Accounting Standards. The Committee is concerned to note that it is not the case at present, particularly with the valuation of heritage and cultural assets.

7.3 A new asset valuation strategy

The Committee is pleased that Victoria has been at the forefront of developments in the valuation and reporting of cultural, heritage and infrastructure assets. After a number of years experience, most agencies appear to have bedded down the valuation process. The valuations have been undertaken by individual agencies under the broad policy framework set by the Department of Treasury and Finance. In relation to the implementation of the policy, the Committee has observed that only limited practical guidance, training and support has been provided by the Department of Treasury and Finance. This approach, in part, may have been influenced by the ‘let the managers manage’ philosophy of previous Governments.

Given the magnitude of the valuation task, the relatively tight timelines, and the specialist skills involved, many agencies resorted to the use of outside consultants and valuers. The Committee did not canvass the question as to whether this was cost effective, but did note the extent to which the external consultancies quantified the cost of the exercise, this assisted to focus the attention of decision-makers on the dimension of the task and the need to harness the benefits of the work.

Experience has shown that a large number of the issues encountered in asset valuation are common to many agencies but at present, there are no formal mechanisms in place to facilitate:

- the resolution of general issues that are not agency-specific; and
• the exchange of knowledge, experience and information between agencies.

To assist agencies in taking the asset valuation process forward, the Committee has recommended the adoption of a new strategy with a number of key elements. The elements cover both the accounting/reporting rules and the implementation process. The Committee believes that the adoption of the strategy will lay the foundations for a more consistent, reliable and cost-effective asset valuation approach for the future. The following are the key elements of the strategy:

• the Australian Accounting Standards Board be requested to:
  – provide detailed guidance on the full implications of the change from the ‘deprival value’ method to the ‘fair value’ method of valuation;
  – re-examine the current requirement for public sector agencies to value cultural and heritage assets and stewardship land for financial reporting purposes; and
  – allow particular forms of condition-based depreciation and renewals accounting for infrastructure assets under specified circumstances.

• the Department of Treasury and Finance be requested to:
  – develop an asset valuation manual setting out the broad policy framework, providing practical guidance on the common implementation issues, and examples of best practice;
  – establish a Reference Group (with representatives from agencies, the Auditor-General’s Office and the Valuer-General’s Office) to assist in the development and maintenance of the asset valuation manual and the resolution of non-agency-specific issues;
  – provide ongoing training to agencies including the conduct of workshops, seminars and discussion forums;
  – establish formal liaison and support networks to facilitate the exchange of knowledge, experience and information across agencies;
create a special website to enable the sharing of information within the public sector and to provide support for issues and knowledge management;

introduce separate stewardship reporting regimes (forming part of the annual financial statements) for cultural and heritage (including collection) assets and stewardship land;

prescribe additional disclosures in the annual financial statements on agencies’ performance in managing the infrastructure and other physical assets under their control; and

provide a more comprehensive policy framework, together with implementation support, for integrated asset management across the public sector.

agencies in the Victorian public sector be requested to:

work together in undertaking future asset valuations and also to benchmark their practices with similar entities both locally and in the other Australian jurisdictions;

dedicate adequate resources to the improvement of asset management on a whole-of-life basis and to the better integration of the accounting and planning systems with the asset management systems; and

maximise the use of asset valuation, depreciation and maintenance information in the context of operational and financial management.

the Victorian Auditor-General’s Office be requested to:

provide input to the development and maintenance of the asset valuation manual and also to the resolution of practical asset valuation issues; and

benchmark its audit methods for tangible capital assets with those applied by other Australian Audit Offices.

the Victorian Valuer-General’s Office be requested to:

play a part in the development and maintenance of the asset valuation manual; and
work with Valuers-General in other jurisdictions, the Australian Valuation and Property Standards Board and private sector valuers to solve common asset valuation issues identified by the Victorian agencies.

Earlier chapters of this report contain further details relating to each of the above points.

7.4 Conclusions

The asset valuation strategy recommended by the Committee is intended to set a new direction for agencies in the Victorian public sector. The valuation process is not an end in itself but a means to provide relevant information for decision-making. Agencies, therefore, should view asset valuation as more than a corporate finance matter and seek to integrate the information produced into the mainstream management process. The ultimate aim of the accrual accounting reform is to improve performance in service delivery, resource allocation and asset management.

The Committee’s recommendation to introduce supplementary stewardship reporting on cultural and heritage assets, stewardship land and the management of infrastructure assets acknowledges a major issue raised by the stakeholders of Government agencies. The reporting of the financial value of assets alone is insufficient to account for agencies’ performance in managing the assets entrusted to them. From the stakeholders’ perspective, knowing the value of the assets held by an agency as well as the cost of using the assets is important but the financial information needs to be complemented by other non-financial information, if the accountability obligations are to be adequately discharged.

In undertaking future valuations, agencies must work together and the Department of Treasury and Finance must assume an active role in policy leadership, and assist with the education of the public sector. Both the Auditor-General’s Office and the Valuer-General’s Office also have a significant part to play in resolving issues identified by agencies. The proposed asset valuation manual should be viewed as a ‘living’ document that provides agencies with a roadmap for delivering the outcomes desired by the Government.
To successfully implement the new approach to asset valuation and management, the Department of Treasury and Finance would need ongoing commitment from the senior management of agencies. To ensure such commitment, the Department may need to adopt a communication and education strategy aimed at raising agencies’ level of awareness and understanding of the process involved and its objectives.
## APPENDIX 1: SUBMISSIONS RECEIVED

<table>
<thead>
<tr>
<th>Name of individual / organisation</th>
<th>Submission number</th>
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<tbody>
<tr>
<td>Arts Victoria</td>
<td>27</td>
</tr>
<tr>
<td>Australian Accounting Standards Board</td>
<td>11</td>
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<tr>
<td>Australian Valuation Office, Darwin Region</td>
<td>30</td>
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<tr>
<td>Barwon Water</td>
<td>23</td>
</tr>
<tr>
<td>Ms Carmel Capitanio, School of Business, LaTrobe University</td>
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</tr>
<tr>
<td>Professor Garry Carnegie, Head, School of Accounting and Finance, Deakin University</td>
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<td>City of Melbourne</td>
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<tr>
<td>Department of Treasury and Finance</td>
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<tr>
<td>Ernst &amp; Young</td>
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<td>Gippsland Water</td>
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<td>Goulburn Valley Water</td>
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<td>Goulburn-Murray Water</td>
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<td>Grampians Region Water Authority</td>
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<td>Heritage Victoria</td>
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<td>Hobsons Bay City Council</td>
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<td>Horsham Rural City Council</td>
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<td>Indigo Shire Council</td>
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<tr>
<td>Knox City Council</td>
<td>24</td>
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<tr>
<td>Mr Richard Llewellyn, University of Sydney</td>
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<tr>
<td>Melbourne Water</td>
<td>29</td>
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<tr>
<td>Mr Allan Molland, School of Accounting and Law, RMIT University</td>
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<td>Moorabool Shire Council</td>
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<td>Moreland City Council</td>
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<td>Museum Victoria</td>
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<td>National Gallery of Victoria on Russell</td>
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<td>North East Water</td>
<td>6</td>
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<td>Mr John Prideaux</td>
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<tr>
<td>Royal Botanic Gardens Melbourne</td>
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<td>Shire of Strathbogie</td>
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<td>Trust for Nature</td>
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<td>VicRoads</td>
<td>25</td>
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<tr>
<td>Victorian Auditor-General’s Office</td>
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<td>Yarra Valley Water</td>
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</table>
## APPENDIX 2: LIST OF WITNESSES WHO GAVE EVIDENCE AT HEARINGS

### 12 October 2000 - Melbourne

<table>
<thead>
<tr>
<th>Organization</th>
<th>Witnesses</th>
</tr>
</thead>
<tbody>
<tr>
<td>Museum Victoria</td>
<td>Mr M Hallett, Deputy Chief Executive Officer</td>
</tr>
<tr>
<td>Specialist adviser to the Inquiry</td>
<td>Mr I Langfield-Smith, Lecturer, Department of Accounting and Finance, Monash University</td>
</tr>
<tr>
<td>Victorian Auditor- General’s Office</td>
<td>Mr G Pound, Assistant Auditor-General, Accounting and Auditing Policy; and Mr E Hopp, Director, Accounting and Auditing Policy</td>
</tr>
<tr>
<td>VicRoads</td>
<td>Mr D Thompson, Director of Finance</td>
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### 10 November 2000 - Melbourne

<table>
<thead>
<tr>
<th>Organization</th>
<th>Witnesses</th>
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</thead>
<tbody>
<tr>
<td>Australian Accounting Standards Board</td>
<td>Mr K Alfredson, Chairman; and Mr J Paul, Senior Project Manager</td>
</tr>
<tr>
<td>Deakin University</td>
<td>Professor G Carnegie, Head, School of Accounting and Finance</td>
</tr>
<tr>
<td>Mr Frank Micallef</td>
<td>Formerly with Australian Accounting Research Foundation</td>
</tr>
<tr>
<td>National Gallery of Victoria on Russell</td>
<td>Mr G Newcombe, General Manager</td>
</tr>
<tr>
<td>Royal Botanic Gardens Melbourne</td>
<td>Professor J Ross, Chief Botanist of Victoria; and Ms L McAllister, Research Officer</td>
</tr>
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</table>

### 13 December 2000 - Canberra

<table>
<thead>
<tr>
<th>Organization</th>
<th>Witnesses</th>
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<tbody>
<tr>
<td>Australian National Audit Office</td>
<td>Mr M Watson, Group Executive Director; and Ms L O’Brien, Executive Director</td>
</tr>
<tr>
<td>Australian National University</td>
<td>Professor A Barton, Department of Commerce, Faculty of Economics and Commerce</td>
</tr>
<tr>
<td>Australian War Memorial</td>
<td>Mr M Whitmore, Assistant Director, National Collections</td>
</tr>
<tr>
<td>Department of Finance and Administration</td>
<td>Mr B Kaufman, Head, Commonwealth Accounting Centre of Excellence Team</td>
</tr>
<tr>
<td>National Gallery of Australia</td>
<td>Ms M Baird, Head of Finance</td>
</tr>
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### 14 December 2000 – Sydney

<table>
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<tr>
<th>Location</th>
<th>Witnesses</th>
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<tbody>
<tr>
<td>Australian Museum</td>
<td><strong>Professor D Griffin, Former Director</strong></td>
</tr>
<tr>
<td>Mr Richard Llewellyn</td>
<td><strong>Manager, Collection Valuation Project for Australian Museum, Powerhouse Museum, State Library, Royal Botanic Gardens and NSW Parliamentary Library</strong></td>
</tr>
<tr>
<td>New South Wales Auditor-</td>
<td><strong>Mr B Sendt, Auditor-General; Mr R Williams, Principal Policy Adviser; Mr S Kalagurjevic, Director of Audit; and Ms M Spriggins, Director of Audit</strong></td>
</tr>
<tr>
<td>General’s Office</td>
<td></td>
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<tr>
<td>New South Wales Treasury</td>
<td><strong>Mr A Waddington, Finance Manager, Crown Transactions; and Mr M Smith, Senior Policy Adviser</strong></td>
</tr>
<tr>
<td>University of NSW</td>
<td><strong>Professor B Walker, Professor of Accounting, School of Accounting and Chairman of the Board, Superannuation Administration Corporation of NSW</strong></td>
</tr>
<tr>
<td>University of Sydney</td>
<td><strong>Professor P Wolnizer, Dean, Faculty of Economics and Business</strong></td>
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### 7 March 2001 – Melbourne

<table>
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<th>Location</th>
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<tbody>
<tr>
<td>Australian Valuation Office</td>
<td><strong>Mr G Addicott, Regional Manager, Darwin Region</strong></td>
</tr>
<tr>
<td>Department of Treasury and Finance</td>
<td><strong>Mr S Gurr, Acting Director, Financial Policy and Compliance; and Mr W McGregor, Stephenson McGregor Consultants</strong></td>
</tr>
<tr>
<td>La Trobe University</td>
<td><strong>Ms C Capitanio, Lecturer, Department of Accounting and Management, School of Business</strong></td>
</tr>
<tr>
<td>RMIT University</td>
<td><strong>Mr A Molland, School of Accounting and Law</strong></td>
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### 10 April 2001 – Melbourne

<table>
<thead>
<tr>
<th>Location</th>
<th>Witnesses</th>
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<tbody>
<tr>
<td>City of Melbourne</td>
<td><strong>Mr R Marsh, Manager, Valuation and Rates Unit</strong></td>
</tr>
<tr>
<td>Ernst &amp; Young</td>
<td><strong>Mrs R Picker, Partner and Business Unit Director, National Accounting and Auditing Standards</strong></td>
</tr>
<tr>
<td>Organisation</td>
<td>Responsible Party</td>
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<tr>
<td>--------------------------------------------</td>
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<tr>
<td>Melbourne Water</td>
<td>Mr B Forrester, Chief Finance Officer</td>
</tr>
<tr>
<td>Moorabool Shire Council</td>
<td>Mr G Jakob, Director, Corporate Services; and</td>
</tr>
<tr>
<td></td>
<td>Mr K Caldwell, Accountant</td>
</tr>
<tr>
<td>Office of the Valuer-General of Victoria</td>
<td>Mr J Dunham, Valuer-General; and</td>
</tr>
<tr>
<td></td>
<td>Mr G Balfour</td>
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